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LawSchool

**An Introduction to**

# **Contract Law in Timor-Leste**

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## ACKNOWLEDGEMENTS

Timor-Leste has much to be proud of in the wake of highly successful, fully democratic presidential and parliamentary elections earlier this year. Over the last decade, there has been significant progress in building a legal system and broader state committed to the values in the Constitution, but the state building process requires ongoing effort. This volume focuses on one such area, the creation and enforcement of contracts. The topic is now vitally important to Timor-Leste, and will become even more so in the years to come. Contracts are also a foundational topic in legal education in both civil and common law countries.

Contracts are important because they allow individuals and businesses to plan for the future. They significantly reduce the risk of broken promises by assigning penalties to those who break their promises. Because there are penalties for breaking contractual promises, people are less likely to do so. Binding promises have been central to organized societies throughout history.

Contracts empower individuals and businesses to effectively make their own legal rights. In other words, they spread power throughout societies by enabling individuals to determine their own legal rights. Contract law is fundamental to having reliable personal, business, and governmental agreements and a state based on the rule of law. The Constitution of Timor-Leste, Section 1, states that the Democratic Republic of Timor-Leste is “a democratic, sovereign, independent and unitary State based on the rule of law, the will of the people and the respect for the dignity of the human person.” The rule of law means that the society is constrained by the law and constitutional principles.

*An Introduction to Contract Law in Timor-Leste* is the second in a series of law textbooks produced by the Timor-Leste Legal Education Project (TLLEP) to critically engage the reader in

thinking about the laws and legal institutions of Timor-Leste. Founded in March of 2010, TLLEP is a partnership between The Asia Foundation and Stanford Law School funded by the United States Agency for International Development (USAID) through its Access to Justice Program. The project's goal is to institutionalize ways for local actors, in close partnership with The Asia Foundation, Stanford Law School, and USAID, to positively contribute to the development of domestic legal education and training in Timor-Leste. In addition to *An Introduction to Contract Law in Timor-Leste* and *An Introduction to Professional Responsibility in Timor-Leste*, TLLEP has completed a textbook on Constitutional Law and a draft Introduction to the Law of Timor-Leste textbook. All texts are updated as the legal landscape changes. The most recent version in all three languages is always available for download online free of charge on TLLEP's website: [www.tllep.stanford.edu](http://www.tllep.stanford.edu).

The textbooks receive vital input from the National University of Timor-Leste (UNTL) faculty and staff throughout the drafting and review process including comments from Rector Aurelio Guterres, Law Dean Tome Xavier Geronimo, Professor Benjamin Corte Real, Professor Mieko Morikawa, Professor Maria Angela Carrascalao, and Vasco Fitas da Cruz of the Portuguese Corporation. As always, the feedback from UNTL students on draft text was immensely helpful for the final text.

As with other texts in the series, *Introduction to the Law of Contracts* focuses on writing in clear, concise prose, and on using hypothetical legal situations, discussion questions, and current events. Through this style of writing and pedagogy, the aim is to make these texts accessible to the largest possible audience. Published in Tetum, Portuguese, and English, the professional responsibility text and subsequent texts are designed to be broadly accessible to experienced Timorese lawyers and judges, government officials, members of civil society,

Timorese students of law, and the international community.

The primary authors of *An Introduction to Contract Law in Timor-Leste* were Khalial Leigh Withen (Stanford Law School '12) and Katherine Plichta (JD '13/ MBA '13) with Rufat Yunayev ('11). Geoffrey Swenson ('09), TLLEP's in-country director and Access to Justice Law Program Manager for The Asia Foundation's Dili office played a crucial role in every aspect of the textbook's creation. Brazilian lawyer Dennys Antonialli (LLM '11) was essential in reviewing the texts to ensure the accuracy of text in both English and Portuguese. Timotio de Deus likewise worked to ensure the Tetum version was technically correct. Attorney Kathryn Blair ('11) and Hogan Lovells provided invaluable pro bono assistance in preparing these materials. USAID Timor-Leste's financial and programmatic support has made the entire endeavor possible and has been vital to the program's ultimate success, with thanks to USAID Mission Director Rick Scott, Ana Guterres, and Peter Cloutier. The US Embassy in Dili, especially Ambassador Judith Fergin, has been immensely supportive.

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We hope that Timorese legal scholars, judges, lawyers, politicians, bureaucrats and students find this textbook useful as you build the state to which you and your forefathers aspired for many decades. I know that my students at Stanford and I are inspired by the state-building project on which you have embarked, as are our partners at USAID, the United States Embassy, and The Asia Foundation.

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## **CHAPTER 1: INTRODUCTION TO CONTRACTS**

Students around the world study contract law because contracts are necessary for the existence of trade, ownership, and for the creation of wealth. Contracts allow businesses to plan for the future, because they create legal rights to certain future outcomes. However, forming an enforceable contract that is appropriate for solving a particular business problem is not always easy. Businessmen often need lawyers to help them create effective contracts. Through studying this textbook, you will learn the basics of contract law in Timor-Leste. You will begin to understand how you can help businessmen and women in your community to plan for the future and contribute to the economic development of Timor-Leste.

### **TEXT OBJECTIVES**

- To understand who can form contracts, and the legal rules they must follow to make enforceable contracts.
- To explain how courts will interpret contracts and the effects court interpretations will have on contracting parties' legal rights.
- To illustrate common contract errors that prevent contracts from being enforceable.
- To understand how contracts can be cancelled once they are created.
- To explain what legal rights result from the creation of contracts, and what happens when a party fails to perform, or do, his or her duties under the contract.
- To understand the various types of contracts that can be formed under the Timor-Leste Civil Code.
- To illustrate the remedies available to injured parties when their counterpart in a contract does not perform his or her duties under the contract.



## **1. Contracts Defined**

A contract is a type promise or agreement that the law can enforce. This means that the courts can force the person who made the promise to either do what they promised or can require them to pay money, called damages, to make up for not doing what they promised to do. More technically, a contract is a promise or multiple promises, normally between two or more people or organizations, called “contracting parties,” agreeing to undertake certain legally enforceable duties or obligations in exchange for certain legally enforceable rights or entitlements. Courts generally require contracting parties to fulfill their promises to one another if it was the parties’ intent to make their promises the kind of promises that neither party can get out of, which are called “legally binding.” If the courts did not enforce contracts, then contracts would not have any value. The value of contracts is that they are legally guaranteed. Imagine what would happen if a court refused to hold contracting parties to their promises? No one would go to the trouble to make contracts because they would not be any better or more valuable than using simple promises. But what is the value of contracts? Why do we need them in the first place?

## **2. Reasons for Contracts**

Contracts are important because they allow individuals and businesses to plan for the future. They significantly reduce the risk of broken promises by assigning penalties to those who break their promises. Because there are penalties to breaking a promise made in a contract, people are less likely to break the promise. Also, even if they do break the promise, because the court will force the person or organization that broke the promise to do what they said they would do anyway, or to pay the person or organization that they broke the promise to money as compensation, the victim of the broken promise is much better off with a contract. A person entering a contract is not afraid to enter the contract because they know that the other person or organization will not want to break the contract because if they break the contract they will be penalized. They are also not afraid because they know that even if the other party does break the promise, the court will make sure that either the agreement happens anyway or that the victim is compensated for the broken promise. They know that no matter what, once they enter a contract, they are safe. By enabling individuals and businesses to have confidence that those they contract with, called their “counterparties” or “counterparts,” will carry out their promises, or pay them compensation if they don’t, contracts serve an extremely valuable purpose in society. Because

people entering into contracts don't have to be afraid, they are more likely to make promises and agreements that they would not want to make if they thought the person or organization they were making an agreement with might break their promise. Because there is less risk, there can be and generally are more agreements and with more agreements more business, more buying and selling, and a better economy. For this reason, binding promises have been central to organized societies throughout history. The ancient Romans, for example, followed the legal maxim *pacta sunt servanda* (agreements are to be kept), which is still considered one of the most basic principles of contract law. Aside from economic considerations, contracts are important because they empower individuals and businesses to effectively make their own legal rights. In other words, they spread power throughout societies by enabling individuals to determine their own legal rights.

### **3. Reasons for Contract Law**

Contract law is fundamental to having reliable personal, business, and governmental agreements and a state based on the rule of law. The Constitution of Timor-Leste, Section 1, states that the Democratic Republic of Timor-Leste is “a democratic, sovereign, independent and unitary State based on the rule of law, the will of the people and the respect for the dignity of the human person.” The rule of law means that the society is constrained by the law and constitutional principles. In addition, the Constitution of Timor-Leste, in Section 138, establishes the state's economic organization by stating that the “economic organization of East Timor shall be based on the combination of community forms with free initiative and business management, as well as on the coexistence of the public sector, the private sector and the co-operative and social sector of ownership of means of production.” Community forms and free initiative both rely on contract law.

The law of contracts exists in the form it does in order to achieve several important goals:

- To increase the security and reliability of business investments and transactions
- To ensure that government agreements are secure and reliable
- To avoid contract disputes by promoting clear communication between individuals
- To make it easier to mediate and enforce all types of agreements
- To save time and increase the efficiency of contracts by discouraging the breaking of contracts, known as a “breach”

- To establish a process where the victim of a breach of contract can get their agreement fulfilled or be compensated for the damages created by the breach. This solution to a breach is known as a “remedy.”

Altogether, the Timor-Leste Civil Code establishes laws for making valid contracts, doing what was promised in the contract, and enforcing contracts by making sure that the other person or organization does what they promised to do in the contract. Establishing rules about the right way to form, or make, a contract helps lawyers and individuals draft contracts that are easy to understand and that are not confusing. Easy to understand contracts minimize misunderstandings among those who are making the agreement and therefore reduce the number of mistakes and legal challenges to contracts. By having fewer misunderstandings, mistakes, and legal challenges all parties save time and money.

Contract law is also important to prevent abuses from occurring and to establish fair grounds for contracts to be performed. Think about an illiterate person signing a contract he or she cannot read or a child being misled to make some sort of binding promise. Many provisions of contract law will be aimed at these situations, making sure that parties act in good faith and according to Timorese law.

#### **4. Enforcing Contracts**

The focus of this textbook is contract formation and understanding what legal rights and remedies are created through creating a legally valid and enforceable contract. However, there is another important part of contract law, which is contract enforcement. For a lawyer to effectively seek enforcement of a contract, he or she must have good negotiating skills, an understanding of court procedure in contract disputes, and attention to details.

Imagine that you are a lawyer and a client has come to you with a problem. The client’s “counterparty,” who is the person with whom the client had an agreement, has failed to “perform”, which means to do his duties under a contract. As you will learn later in this textbook, different types of contracts are governed by different sets of legal rules. Identifying the type of contract your client has is thus the first step in determining how to proceed. Once you have identified the contract, you must determine whether your client has a valid legal claim. This means you must make sure that your client has a legal right that you can use the law to enforce in court. You should ask her questions about the contract. For instance, was the contract recorded in

writing? Was the client's counterparty drunk, mentally ill, or in some other way impaired when he entered into the contract? You will want to ask the client to tell her story of how the contract was formed and what happened afterwards. Then you can use your knowledge of contract law to ask specific questions about the story to get facts that are important for legal reasons.

Now imagine that, after talking with your client, you determine that she has a valid claim; meaning that she has the legal right to have her contract enforced. What do you do now? Well, the first thing you will want to do is to try negotiating with the defendant, or his lawyer, to avoid a lawsuit altogether. The threat of a lawsuit can make a defendant more willing to bargain since trials are expensive, time consuming, and the outcome sometimes difficult to predict. It can take over three years for a case to be decided by the court, and in many cases your attorney's fees can cost the client more than the entire amount of their claim. Even after the judgment becomes final, there is a long process for enforcing a judgment. Therefore, you should attempt to negotiate a mutually acceptable agreement with the defendant, if possible, before undertaking this process. The full details of the court procedures that you will have to follow if your client decides to take the case to court are a different topic than contract law called "civil procedure" and are therefore not included in this textbook. However, even though it is not in this textbook, you must learn about civil procedure before representing clients in contract disputes.

## CHAPTER 2: FORMATION OF CONTRACTS

### I. INTRODUCTION

Before thinking about enforcing contracts, you must first understand how to form them. Forming valid and effective contracts requires careful advance planning, but it is not necessarily a complex task. Forming contracts can be easy and exciting once you learn the basic rules for writing contracts, called “drafting,” how to take the steps necessary to make the contracts legally enforceable, known as “perfecting” a contract, and how to avoid common drafting mistakes. By helping an individual or business to form a contract with a counterpart, you help that person, NGO, or business to solve an important legal problem. You help them to improve their economic position, and you help the economy of Timor-Leste to develop.

For a valid contract to be formed, it must be drafted correctly and perfected. The term “perfected” is a legal term meaning three things: 1) that the parties have come to an agreement that they all understand all of the details and terms of without any misunderstandings, 2) that each party agrees to be required to fulfill their part of the agreement, and 3) that all formal legal requirements for contract formation have been met. While there are many formal legal requirements for contract formation in the Timor-Leste Civil Code, many of these rules apply only to specific types of contracts like, for example, mortgages. The legal rules that apply to all contracts are called the “General Theory of Contract Law” and include: 1) rules that regulate who can form a contract, 2) rules that govern how contracts are formed, and 3) rules that specify what happens after a contract is formed. Before discussing these legal rules in detail, a short summary of each of these three is provided below.

#### *Who can form a contract?*

In order to form a contract one must have “legal capacity” to participate in contracts and to exercise legal rights. Put simply, legal capacity is the ability to reason and make competent, reasonable, and informed decisions regarding one’s rights and obligations. A contract with a person lacking legal capacity is voidable, meaning it can be canceled, under the law of Timor-Leste. So if you are considering making a contract with someone potentially unable to make competent decisions, e.g., a young child or someone who is intoxicated, you will want to make sure that person has legal capacity to make a contract with you, or else you could end up with a

voidable contract. Additionally, parties can arrange for representatives to make contracts for them. This allows lawyers, and even friends and family members, to enter into contracts on behalf of someone else. In a case where someone is having a representative make a contract for them it is important to be especially careful about the powers of representation since it is not always easy to tell if the person entering the contract is the one with sufficient powers to represent the legally incapable person. To summarize, all people who have legal capacity, and their representatives, can make contracts under Timorese law.

### *How are contracts formed?*

At the most simple level, a contract is formed when two parties make declarations of willingness which show that they want to be bound by that contract. A declaration of willingness is the showing of a party's willingness to undertake certain legal obligations, under certain legal conditions. However, declarations of willingness can fail to form a legally enforceable contract if the parties making the declaration lack *actual* willingness to be contractually bound. Also, when you make certain types of contracts, the law requires that you use a particular "form," which is a set of rules that specify how a declaration of willingness is to be made. For example, some types of contracts must be made in writing. In addition, you can include conditions in contracts. Conditions are optional clauses, or pieces of contracts, that make a contract's validity, or part of a contract's validity, depend upon an uncertain event. These are helpful because they allow you to make agreements about uncertain things in the future and can help protect you from being harmed if something bad happens.

### *What happens when a contract is formed?*

The Timor-Leste Civil Code contains specific rules for when a contract proposal, or offer, is considered effective. This is important, because after a contract proposal becomes effective, the person or organization typically has a limited amount of time to accept the proposal before it expires. Sometimes the person who was offered the agreement has a limited time to reject the proposal before they are deemed to have accepted it through their silence. Once a contract becomes effective, the parties to the contract are obligated to perform their responsibilities under the contract, in other words to do what they promised to do in the

agreement. Most of the time, parties perform their responsibilities under the contract as expected. In some cases, however, one or more parties fail to perform and a dispute occurs.

When contract disputes occur, the party that did not perform often argues that the contract is void and unenforceable, meaning that he did not have any legal responsibilities to perform in the first place. A common argument is that there was an error in the formation of the contract. For example, a defendant might argue that she did not voluntarily consent to be bound by a contract's terms. She might claim that she misunderstood the purpose of the contract, and that there was thus a "will-related fault," meaning that she did not "will," or want, the contract as it actually existed, but thought that she was agreeing to something else. Parties to contracts can also seek to nullify or annul a contract before a dispute occurs. To nullify or annul a contract means to cancel it and undo its legally binding power. It is very important to know that there is a difference between nullifying a contract and annulling a contract as it will come up much more in the future. The two are explained below:

*Voidness:* For a contract to be considered null and void, it has to be "born dead" or made in such a way that it could never be legally valid. For example, a contract to sell a person into slavery would be null and void because such a contract is completely illegal, immoral, and was never binding at all. Even if all of the people involved in the contract, including the slave, wanted the contract to be binding and legally enforceable, the court would not let them and would declare the contract null and void anyway. For these cases, the contract is so broken that it has never been valid and has never had legal force. With contracts that can be nullified, anyone can tell the court to nullify the contract or the court can decide on its own to nullify the contract. With contracts that can be nullified, it does not matter how long the contract has existed, it can be nullified many, many years in the future. Contracts which are declared null and void by courts should not have produced any legal effects, giving courts the ability to nullify every effect that the contract has produced so far, re-establishing the situation of the parties before the formation of the contract (*status quo ante*). It should be just as if the contract had never existed. For instance, if a child has purchased a car in instalments and a court declares this contract is null and void because the child lacks legal capacity, the instalments paid so far should be reimbursed to the child. We use the latin expression "*ex tunc*" to refer to this situation where all the effects of a contract are undone.

*Annulment:* If a contract is annulable, it means that it is a working, functioning, binding, contract, but that it has problems, and can be cancelled in some circumstances. In this case, if the no one objects to the contract or tries to cancel it, it might eventually become binding like a normal contract and can no longer be cancelled. How long someone has before they can cancel, or annul, a damaged contract depends on the type of contract, but it is normally a year. An example of an annulable contract is a contract where one party tricks the other party into agreeing to the contract by lying about what the responsibilities and obligations in the contract are. In this case, the person who is tricked has the choice to annul the contract, but also has the choice to stay in the contract if they want to. Also, if they wait too long to annul the contract, the law will eventually not let them annul it because they waited too long. Finally, the only people who can ask to annul a contract are the parties or a third party affected by the contract; the court is never allowed to annul a contract on its own. When a contract is annulled, the effects that were produced so far may be considered valid and only the ones to be produced are cancelled. We use the latin expression “ex nunc” to refer to this situation where only the future effects are cancelled. Timorese Law determines that annulment also operates retroactively pursuant to Article 280 (1). In case of annulment, however, it is possible that effects that have been produced are preserved as it is the case for contracts paid in instalments or of continuous performances.

To help remember the difference between the two, just remember that “null” means “none” or “nothing” like there is no real contract and there never was. This is because null contracts are wrong enough that the court considers them nothing, not even contracts: they are “nothing”. On the other hand, “annul” just means “to cancel,” and means that it is the kind of contract that is just broken enough that someone can cancel it if they want to, but they don’t have to if they don’t want to.

In order to make contract enforcement predictable, the Timor-Leste Civil Code sets out rules for how courts should interpret declarations of willingness, and thus contracts. For example, courts are allowed to “incorporate,” or include in the contract, the meaning of missing provisions. When they do this the courts try to only include provisions that the parties would probably have included on their own when they first made the contract if they had realized that they needed them. This is most often done in cases where complete cancellation of a contract would either be costly or unnecessary. For this reason, the Civil Code gives parties the ability to



either 1) remove the faulty or broken part of the contract, or 2) change the contract into an acceptable form.

Now that you have an overview, let's look at the legal rules for contract formation in more detail.

## II. LEGAL CAPACITY

### SECTION OBJECTIVES

- To understand that one must have legal capacity to participate in contracts and to exercise one's legal rights.
- To explore reasons for legal incapacity, including age, mental impairment, and substance abuse.
- To understand when contracts are voidable on the basis of incapacity.

#### 1. What does legal capacity mean?

Capacity is the ability to reason and make competent decisions regarding one's rights and obligations. For example, capacity describes one's ability to understand and compare the possible risks and benefits of a particular decision, such as deciding whether or not to buy a house that needs roof repairs. There may be short term benefit to buying a cheaper house because you will have more money to spend on other things, but there are also long term costs like the time and resources you will need to repair the roof. Most people make regular decisions about purchases and the amount of work they will do, and capacity is the ability to fully understand the responsibilities one undertakes with each decision. If a person with normal capacity agrees to fix a roof within two weeks it means that they have been able to think through all the steps necessary to fix the roof and reasonably think that they can finish all of those steps within two weeks. One has to understand the cause of the roof leak, which tools and supplies one will need to fix it, where to obtain the tools and supplies, the method for repairing the roof, and roughly how much time the repair work will require. When making commitments to do something, a person should understand what it will take to complete the agreement, whether it is an agreement to pay rent for a room or an agreement to complete certain tasks within a certain amount of time. Like fixing a roof or buying a house, most contractual decisions require understanding multiple different things involved in the agreement and its potential risks and benefits.

Chapter 1 of the Timor-Leste Civil Code (TLCC) describes legal capacity for natural persons in Article 64.

Article 64  
Legal Capacity

Any person may be a party in any legal relationship, except as otherwise provided by law. This is what defines his or her or her legal capacity.

Capacity is therefore the ability to fully engage in legal relationships. It is important to distinguish between “legal capacity” and “personality” (Art. 63 TLCC). While “personality” is the ability to *have* rights, “legal capacity” is the ability to *exercise* rights on your own. According to Timorese Law, one has “personality” since his/her “complete birth with life”. “Legal capacity”, on the other hand, is acquired when minority ceases (at the age of seventeen), under Article 118 TLCC. Thus, a minor has “personality” but not “legal capacity”. That means, for instance, that a minor can own a house (*have* property rights) but cannot engage in legal relationships that affect this right, such as the sale or the rent of the house, without due representation.

Article 66 of the Timor-Leste Civil Code states that a person may not give up his or her legal capacity, in its entirety or in part. For instance, once a minor becomes a capable adult, she will always have legal capacity, unless something happens to limit her ability to reason or make decisions. She cannot simply decide to give up her legal capacity to make a contract.

## **2. Why require capacity or competence for participation in contracts?**

Chapter 2, Section 95 of the Constitution of Timor-Leste establishes an exclusive mandate for the National Parliament to make laws on “[t]he status and capacity of the person, family law and inheritance law.” In furtherance of the Constitutional mandate, the Parliament drafted sections on capacity in the Timor-Leste Civil Code.

Legislatures designate legal capacity to determine when a person is able to exercise his or her rights and to participate in binding contracts. The Timor-Leste Civil Code generally prohibits minors and adults without capacity from participating in contracts. The purpose of this limitation is to ensure that the contract fairly represents both parties’ interests. A contract is more likely to be fair when two parties with reasonable judgment and decision-making abilities negotiate the

contract with an equal understanding of what all of the terms of the agreement mean, what they require, and what risks might be involved in them. If one person doesn't understand what the contract means or what they are supposed to do as part of the contract because they are too young to understand, or have mental problems that stop them from understanding, there is a risk that the contract will be unfair to them because they did not know that they were agreeing to. Therefore, the requirement of capacity helps prevent vulnerable members of society, like children or the mentally ill, from being required by an agreement to take on risky obligations or unfair responsibilities that they probably are not able to fully understand.

Children and adults without capacity are unable to be legally bound by most types of contracts but not by all types of contracts. There are some specific types of contracts which if a child or incapable adult agrees to, the courts will require them to fulfill their agreement or to pay compensation if they don't. These laws on legal capacity must balance the need to protect the vulnerability of minor children or incapable adults with the interests these children and incapable adults have in making fair contracts for necessary items. Additionally, parties that have contracted with incapable adults or minors have an interest in clear expectations about what is and is not a binding contract. Both parties thus benefit from having clear, easy to understand, rules on legal capacity in contracting. A child benefits because the law prevents adults with more experience from taking advantage of the minor's lack of experience or knowledge. Furthermore, the adult party also can benefit from this law. For example, if an adult selling tools and farm equipment at the market accidentally makes a contract with a minor without knowing that he is a minor, and then later finds out from the minor's parents that the minor is too young to make a contract, there are different outcomes depending on if the law is clear or not. If the law is unclear, the parties may spend a lot of time trying to determine what happens to the contract and whether or not it is still valid. Having a clear law allows both parties to save money and time because they can change their plans to the new circumstances. For example, if the adult quickly learns that a contract for the farm equipment is void, then he can find another customer to buy the equipment. On the other hand, if the adult has to wait to find out if the contract with the minor is valid, then he might not be able to resell the equipment for a long time.

### 3. Who lacks legal capacity to make contracts?

Capacity is the ability to make well-reasoned, rational decisions. Legal capacity provides a minimum standard for the reasoning ability necessary to make legally-binding decisions. The TLCC determines three different circumstances under which a person lacks legal capacity: minority, interdiction and incapacitation.

#### Minority

According to Article 118, a minor is someone “who has not yet completed seventeen years of age.” Under the law, a minor generally lacks legal capacity.

#### Article 119 Minor’s Incapacity

Unless otherwise provided, minors lack the capacity to exercise rights.

Upon completion of the age of seventeen, a person reaches majority and attains legal capacity, being fully able to engage in legal relationships and exercise its rights, as stated in Article 126:

#### Article 126 Effects of Majority

Whoever completes seventeen years of age acquires full capacity to exercise his or her rights, thus becoming qualified to rule over himself or herself or herself and to dispose of his or her property.

This means that people who are younger than seventeen do not bear legal capacity and cannot enter into any contractual relationships without being represented by someone else. If a child owns a house and needs to sell it, it is his/her representative, for instance, his/her parents who shall sign the contract. If any law specifically says that a minor is allowed to enter into a specific type of contract, than they are allowed to enter into that type of contract. However, for every other type of contract, where the law does not mention specifically that a minor may enter into it and be bound by it, the contract is unenforceable against the minor, and the minor cannot

be required to fulfill the contract. This means that as a general rule minors cannot be bound by contracts unless they are represented by someone with legal capacity.

### Interdiction

In addition to minors, adults with limited abilities may lack legal capacity. When a person is unable to care for herself due to a mental or physical disorder, a court may decree that she is not able to exercise her rights. This process is called interdiction.

#### Article 130

##### Persons subject to interdiction

1. All those who, due to a mental disorder or for being hearing, speaking and/or visually impaired, are considered incapable of ruling themselves and their property, may be interdicted from exercising their rights.
2. Interdictions apply to adults; but they may be requested and decreed within the year prior to majority, in order to enter into effect from the day a minor reaches the age of majority.

#### Article 131

##### Capacity of the interdicted person and interdiction regime

Without prejudice to the provisions set out in the following articles, the interdicted person is compared to a minor, and the provisions regulating incapacity due to minority and establishing forms of supplanting parental authority are applicable, with the necessary adaptations.

Therefore, interdiction is a prohibition on exercising one's rights, and usually a court puts in place an interdiction based on one's physical limitations or psychological disorders. Article 130 states that courts may decree that dependent or incapable individuals may not exercise their rights. As a result, Article 133 establishes that courts should treat interdicted persons under the incapacity provisions for minors. Hence, an interdicted person lacks legal capacity to make contracts, just as minors do. A parent, guardian, spouse, manager, relative in the line of succession, or Office of the Public Prosecutor may request the interdiction. (TLCC Article 133: Legitimacy.)

For instance, if Mario gets in a car wreck and has a head injury. His wife notices that he begins to act very differently than in the past. His capacity of reasoning and making decisions has been significantly limited.. She might consider talking to a lawyer about the possibility of court interdiction and guardianship under Articles 130, 133, and 135. Article 135 explains the

order for determining the legal guardian. Since Article 135(1)(a) gives spouses priority in becoming a person's guardian, it is likely that a court would appoint Mario's wife as his guardian. After the interdiction, Mario will be no longer able to exercise his rights on its own. His guardian will act on his behalf.

An interdicted person is legally incapacitated, so their contracts can be annulled. Courts therefore can declare transactions invalid when they were completed after a court's definitive interdiction order has been registered. (TLCC Article 140: Acts of the interdicted person after the sentence is registered.) In addition, if the interdiction order is definitively granted, courts may annul transactions completed during the interdiction process that have hurt the individual. (TLCC Article 141: Acts practiced in the course of action.) If an incapacitated person finalizes a contract before the interdiction action is announced, then the court should apply the accidental incapacity standards. (TLCC Article 142: Remedy for the state of incapacitation.)

In sum, minors and individuals lacking physical or mental abilities to make personal decisions both lack the legal capacity to make contracts. The law provides different ways for incapacitated persons to either attain legal capacity or be represented in contracts by another person. Managers can represent minors or incapacitated individuals to make decisions. Even though some members of society lack the ability to make contracts for themselves, the law ensures that managers shall represent the incapacitated persons' interests.

### Incapacitation

Similarly to interdiction, incapacitation is a process through which one can request a court to prohibit a person from exercising rights on his own, based on a mental disorder or physical disability. Article 144 in Section IV explains several reasons for incapacitation.

#### Article 144

#### Persons subject to incapacitation

A person may be considered incapacitated if his or her mental disorder, hearing, speaking and/or visual impairment, though permanent, is not so serious as to justify his or her interdiction, as well as those persons who, due to their usual prodigality or because of drinking alcohol or of using drugs, become incapable of adequately managing their property.

As stated in the Law, incapacitation deals with less serious mental disorders/ physical impairments. In these cases, the person still has some ability to reason and make decisions but the moments in which he/she loses control represent a threat. For instance, Julia has developed a gambling addiction. Although she is still able to reason and make decisions in some circumstances, her husband fears that she might lose control and offer their house in a gamble bet. He might then seek a lawyer's advice on the possibility of filing an incapacitation action. That way, a court may decree Julia's incapacitation, thus requiring her husband's authorization for engaging in legal relationships. That way, in case Julia gives away her property without her husband's authorization, such legal transaction could be annulled.

According to Article 145 of the Civil Code, an incapacitated person needs the authorization of a trustee to engage in property transactions. This authorization may be also granted by a court. (TLCC Article 145: Remedy for the state of incapacitation.) Note that in the case of incapacitation, the person acts on its own with the *assistance* of a manager, who authorizes the legal transaction. Interdicted persons and minors, on the other hand, cannot act at all because they lack legal capacity completely. They need their guardians to fully act on their behalf.

The rules for annulment of legal transactions made by incapacitated people follow the ones set forth for interdiction. (TLCC Article 148: Supplementary Regime). Allowing an authorized manager is a practical way to address the problem of how to make agreements to benefit the person lacking capacity. For instance, though a minor may not make her own contracts, a parent may want to make an education-related contract on behalf of the minor.

Moreover, these forms of representation allow guardians and managers to take care of the property of a person lacking capacity. For instance, if a minor owns a house and his family needs to move to another city, the minor would not be able to sell it. He needs his guardians to act on his behalf in the sales contract. In the case of interdicted or incapacitated persons, this is a protection to the person lacking legal capacity. They are not be able to manage their property completely on their own, just as in the example of the gambling addiction.

In short, both interdiction and incapacitation are processes that restrict one's legal capacity. They are important since they can be the basis for annulling a legal transaction made by an incapacitated person. If the interdiction or incapacitation action has not been filed at the time the legal transaction was concluded, a court may not annul the transaction on that basis, but



would rather rely on accidental incapacity, which requires evidence to be provided (TLCC Article 248: Accidental Incapacity) . In this sense, requesting one’s interdiction or incapacitation is an important measure of protection for its rights and property.

Last but not least, it is important to bear in mind that requesting one’s interdiction or incapacitation is a serious action. Having your legal capacity restricted represents a severe limitation to one’s freedom to contract. Therefore, courts ought require strong evidence of one’s inability to reason and make decisions to decree an interdiction or incapacitation. The requesting parties and the Office of the Public Prosecutor should also be mindful of such a limitation and file the actions only when necessary.

#### **4. What about businesses or organizations?**

Articles 149 to 158 of the TLCC (Chapter II: Legal Persons) provide the general rules for an entity to attain personality and legal capacity. That is important because it confers the legal entity the ability to exercise rights on its own name, separately from natural persons. A legal entity can therefore contract in the same way capable adults can. The definitions set forth in this Section apply to associations which are not established for economic gain, social foundations, and companies, when appropriate. (TLCC Article 149: Scope of Application.)

Legal entities attain personality, i.e. the ability to *have* rights, with certification, which is individual and conferred by the administrative authority. (TLCC Article 150: Acquisition of Personality). Thus, natural persons attain personality upon their “complete birth with life”; legal entities upon certification. Differently from natural persons, however, legal entities have a default of legal capacity. That is because legal entities are not subject to the same conditions natural persons might be such as minority or physical impairments and psychological disorders.

Legal capacity of legal entities may comprise all the rights and obligations that are needed for their activities, as stated in Article 153.

Article 153  
Capacity

1. The capacity of legal persons comprises all the rights and obligations needed or convenient to achieve their aims.
2. Exceptions are made to the rights and obligations vetoed by law or those that are inseparable from individual personality.

In order to contract, legal entities need to be represented. The representation of legal entities, before courts or in other legal relationships, shall be deemed to the ones appointed in the corporate by-laws, as stated in Article 155. They will act as a legal entity's "eyes and ears" and always on its behalf.

Article 155  
Representation

1. Representation of the legal person, in and out court, is the duty of whoever the statutes determine or, in the absence thereof, of management or of whoever the latter designates.
2. The designation of representatives by the management is only opposable to third parties when it is proved they were acquainted.

The legal capacity of businesses and organizations is a complicated area of law that deeply involves the separate legal field of "corporate law." What is important to know for these purposes is that organizations and businesses also must have capacity to enter into legal contracts and that this capacity is conferred to them by default.

**5. How can an incapacitated person or a minor attain legal capacity?**

Since legal capacity is not necessarily a permanent status, it is possible for a person to be incapacitated at one point and have capacity later on. Timor-Leste Civil Code Article 125 states that a person achieves legal capacity when he or she becomes an adult or is emancipated. Once a person arrives at the age of seventeen (majority), that person may exercise his or her full rights and control of their own property. Article 127 contains an exception. In case there is a pending action requesting the minor's interdiction or incapacitation, a parent or guardian will maintain

control until the sentence is resolved. (Article 127: Pendency of the action of interdiction or incapacitation.)

Besides reaching the age of seventeen, under Article 128 on Emancipation, a minor may obtain his or her emancipation through marriage. This is possible because it is legal to get married in Timor-Leste once one reaches the age of sixteen as long as the marriage takes place with the parent's consent. Once one reaches the age of seventeen parental consent is no longer required.. Emancipation through marriage means the minor may exercise his or her full rights once he or she gets married. One possible reason for the law providing emancipation through marriage is the idea that marriage is an adult agreement, and once a person gets married, he or she should be treated as an adult under the law. However, if a minor enters the marriage without parental consent, then his or her rights are limited regarding the disposal of property brought into the marriage until they reach the age of seventeen according to article 1536.

Ending one's incapacitation caused by consistent drug or alcohol abuse, or excessive and dangerous use, takes a long time under Article 147.

Article 147:  
Lifting the State of Incapacitation

When the state of incapacitation is caused by prodigality or alcohol or drug abuse, lifting it cannot be granted before five years elapse after confirmation of the sentence that decreed it or of the decision that denied a prior request.

Article 147 defines the process for lifting incapacitation due to excessive drug or alcohol use. This process requires a minimum wait of five years after a court decree declaring the person incapacitated before the person is deemed to have capacity again. The five-year minimum wait probably is rooted in the belief that recovering from drug or alcohol abuse, by necessity, will take a significant amount of time.

For instance, imagine that Julia drinks so much that she frequently tries to sell her family's belongings while intoxicated. After many family problems, the court designates Julia as an incapacitated person. Later the court permits Juana, her guardian, to manage Julia's property. Since the court may not lift the state of incapacitation for at least five years after the sentence, Juana probably will manage her property for at least five years, even if Julia happens to be

completely recovered after three years. . Do you think five years is a fair amount of time to require for recovery from incapacitation? Is this perhaps a law that would benefit from being modified so that incapacitation could be lifted earlier if a judge thought that it was appropriate to do so? Is it possible that being unable to enter into contracts on their own might slow down the recovery of someone with a drug or alcohol addiction or abuse problem because it would be difficult for them to enter into normal society again?

## **6. General Principle**

One must have legal capacity to exercise rights and enter into contracts. As previously stated, legal capacity is the ability to be a party in a legal relationship including a contract. A person may lack capacity for two general reasons: (1) age and (2) insufficient mental or physical capacity. A minor may not exercise rights independently, and minors' contracts generally are annulable, meaning that they can be cancelled but they do not have to be cancelled. Additionally, an incapacitated person may not make a contract without assistance from an authorized manager. The Timor-Leste Civil Code also outlines specific exceptions to when a minor's contract is able to be cancelled, meaning that some contracts that have to do with the minor's personal work or belongings are not cancellable even though the minor lacks capacity. These types of contracts, which are exceptions, are discussed later on in this chapter.

## **7. What happens if a person lacking legal capacity makes a contract? Can a court annul or void the contract?**

If a minor seeks to contract with another party, despite his or her lack of capacity, a court may annul, or cancel, the contract by request of the legitimate parties, as stated in Article 121. That is particularly important when a minor or incapacitated person engages in an unfavorable legal transaction. Article 121 also states the periods during which annulment can be requested.

Article 121:  
Annulability of Minor's Acts

1. Without prejudice to the provision set forth in paragraph 2 of Article 278, legal transactions performed by a minor may be annulled:
  - a) Depending on the case, on request of the parent exercising parental authority, of the guardian or of the property manager, as long as this suit is filed within one year from the date on which the applicant is informed of the contested transaction, but never after the minor has reached the age of majority or is emancipated, with the exception of the provision set out in Article 127;
  - b) On request of the minor himself or herself or herself, within one year of reaching the age of majority or being emancipated;
  - c) On request of any heir of the minor, within one year of his or her death, if it occurs before the expiry of the deadline referred to in the previous subparagraph.
2. Annulability is reversible upon the minor's confirmation, after reaching majority or being emancipated, or upon confirmation of the parent exercising parental authority, of the guardian or of the property manager, if it is an act that any of them could perform as the minor's representative.

Under Article 121, parents, guardians, the minor, or heirs of the minor may request that the court annul the minor's contracts. If one wants to file a request to annul the minor's contracts, one should check Article 121 carefully for the time limits on the request. If the contract is not annulled in time, then it becomes binding the same as it would be if the contract had been entered into with an adult.

Having a manager essential so that, even though the incapacitated party may not make contracts, there can be a representative to advocate for the incapacitated party's interests. Imagine a minor who is injured in a car wreck. Even though she is not allowed to make contracts, the injured minor still has interests in resolving who was at fault in the car wreck and who should pay for the damage. Since she is unable to represent his or her own interests, she may benefit by having a manager represent her legal interests.

For more information see: Timor-Leste Civil Code Articles 276-78 for general provisions on cancelling transactions; Article 341: Effectiveness of Contracts; Articles 367-71: Contract dissolution; and Article 380: Circumstance in which the contract is not validated. For information on incapacity of parties regarding the contracting of work projects, see Article 1150.

To sum up, contracts made by minors, interdicted or incapacitated persons are subject to annulment. Remember that for interdictions and incapacitations, courts will check if the

interdiction/incapacitation actions had already been at least filed when the contract was made, according to Articles 140 and 141 of the Civil Code.

**8. What if an adult lacking capacity makes a contract before any interdiction/incapacitation action is filed?**

For these circumstances, annulment requests can rely on the concept of “accidental incapacity”, laid out in Article 248. Accidental incapacity means a temporary or permanent unexpected state of incapacity.

Article 248  
Accidental incapacity

1. Any declaration of intent made by somebody who was accidentally unable, due to any cause, to understand its meaning, or could not freely exercise his or her will, is annulable, provided that the fact is clear to the addressee, or known by him.
2. A fact is clear when any average person could have noticed it.

The concept is applicable to various situations, as stated in Article 142. This article therefore functions similar to a safety valve. Take the example of Mario, a blind person who has not been interdicted. He buys a house from Jorge, who does not tell him the house is in an extremely poor condition. Even though the purchase and sales contract cannot be annulled on grounds of Mario’s interdiction, he can still rely on accidental incapacity to request a court to annul it.

**9. What is the basis for annulling a disadvantaged party’s contract generally?**

An additional way to annul a contract is if one party to a contract takes advantage of a disadvantaged party in an interest-bearing deal.

Article 273:  
Usury Interest-Bearing Transactions

1. Legal transactions are annulable, on grounds of usury, when a person takes advantage of the need, inexperience, irresponsibility, dependence, mental condition or weakness of character of another person and obtains, for himself or herself or a third party, the promise or the concession of excessive or unjustified benefits.
2. The special arrangement laid down in Articles 494 and 1066 is safeguarded.

A court has the authority to annul an unjust contract as stated in Article 273. This Article applies if one party takes advantage of another party that has a limited ability to understand decisions in order to gain unjust benefits in a deal or to collect an unfair amount of interest. Giving the court discretionary power as in Article 273 provides flexibility in the judicial system to deal with unforeseen, unjust circumstances. The way that Article 273 functions legally will be discussed at greater length later in the book in Subsection 2 of Section 5 in Chapter 2.

**10. Exceptions to a minor's legal incapacity**

Another example of flexibility in the Timor-Leste Civil Code for unforeseen circumstances is Article 123, which describes exceptions to the general rule that a minor lacks the legal capacity to make contracts.

Article 123:  
Exceptions to Minor's Incapacity

1. Besides others established in the law, the following are exceptionally valid:
  - a) Acts of management or disposition of property that the individual over sixteen years of age acquired through his or her work;
  - b) Legal transactions that are characteristic of the minor's normal life within the scope of his or her natural capacity and only imply expenses, or property dispositions, of a small amount;
  - c) Legal transactions regarding the occupation, art or craft that the minor has been allowed to practice, or those practiced when exercising that occupation, art or craft.
2. For acts regarding the minor's occupation, art or craft and for acts practiced when exercising that occupation, art or craft, only the property the minor freely disposes of can answer.

Article 123 outlines several exceptions to the general rule that minors lack legal capacity. Hence, several types of minors' contracts are valid: a sixteen-year old's contract to manage his

property earned through his work, normal day-to-day transactions involving a small amount of money or objects of little value, and dealings related to the minor's approved work or craft. Article 123 permits small contracts that are generally in the minor's best interest. Allowing minors to make small deals to dispose of property they have earned personally rewards minors for their own work and art. This encouragement can teach minors to manage their work responsibly. Furthermore, small contracts can provide training for making more significant contracts and economic decisions in the future.

For example, imagine Ameu is sixteen years old and buys a bicycle with money from his part-time job. He would be able to draft a contract to sell his bike because it is a sale of property acquired through his own work. It is likely that Ameu also would be able to make contracts to sell other small items. Assuming that his parents allow him to make crafts like weaving or pottery, a judge would be able to permit him to sell his crafts. If Ameu learns more about what types of contracts are fair through his experiences with his own crafts, then he would be better prepared to make larger contracts in the future.

Additionally, these exceptions make it easier for people to engage in many everyday transactions. If you think about it, when simply taking a bus, one is engaging in a transportation contract: one party pays money in exchange for the ride of the bus. If minors were not able to engage in these types of contracts, many everyday activities would be stifled without even representing a considerable threat to a minor's property or rights.

Article 122 establishes another exception to the general rule that minors' contracts are annulable for cases when the minor lied or misled the other party to believe that the minor was actually old enough to negotiate the contract.

Article 122:  
Deceit by the Minor

A minor loses the right to invoke annulability, if in order to practice the act he or she resorted to deceit with the purpose of pretending to have reached the age of majority or being emancipated.

A minor who lies about his age to the other party in conversation or through false documents, therefore, would not be able to annul the contract. By holding minors accountable for



lying about their age to make a contract, Article 122 discourages minors from lying and abusing laws meant to protect them. Additionally, Article 122 prevents adults from significant losses from contracts annulled because the contract was between an adult and a minor. If a minor could lie about his age, make a contract, then obtain some payment from the adult, and later annul the contract, a minor might be able to take advantage of an unaware adult.

Since Article 122 prevents a deceitful minor from being able to annul his contract, a deceitful minor likely would be liable for his commitments in the contract. This may seem to go against the rest of the Code sections on minors' incapacity, which largely focuses on protecting minors from the responsibilities that come from contracts. The code, however, must balance many interests in contracting, including protection of minors as well as adults' interests in being able to negotiate and rely on clear contracts without fear of fraud and contract annulment.

### **11. Can parents or guardians make contracts for minors?**

According to Timor-Leste Civil Code Article 120, parents or guardians take the place of a child in having the capacity to form contracts on the child's behalf. Thus, parents may participate in contracts on behalf of their minor children. Minors also have the duty to obey their parents and guardians, except if that requires engaging in illegal or immoral activities, as is stated in Article 124. This makes sense because parents are better able to make informed contracting decisions regarding school and health care for their children than most children are. This is because most parents know their children better than anyone else except the children themselves do, but also have more experience and knowledge of the world than their children. Additionally, parents are more likely to think about long-term benefits and consequences than minors. Allowing parents and guardians to authorize a contract for their minor child should only result in contracts that the parents believe will benefit the minor.

### **12. What happens to the party of the contract who has capacity?**

A contract with a person lacking legal capacity is voidable under the law. If the court annuls the contract, then the contract does not bind the person with capacity or the person without it. For example, neither the minor nor the adult are bound if the child lacks capacity to enter into the contract. If the minor, though, comes of age and ratifies the contract, or the minor's parent or guardian approves the contract, or the minor was deceitful, then the contract will still

continue to bind both of the parties. In those cases, it is the same as if the minor always had capacity. If the adult fulfilled his or her portion of the contract but the minor did not, the minor usually does not have full liability for the contract. A judge, nevertheless, might order the minor to return or repay what he or she has received.

### **13. Summary of What We Have Learned**

Thus far, we have learned that that personality is the ability to have rights and legal capacity the ability to exercise such rights. The Civil Code generally bars those without capacity from making contracts. Minors, individuals with limited mental or physical abilities, and business organizations are subject to the rules on incapacity. If they try to make a contract, the contracts will be annulable due to a lack of legal capacity unless a manager assisted the incapacitated person or the contract falls into one of the Code's exceptions. Exceptions include contracts regarding the minor's personal craft, the minor's work, everyday contracts involving small sums of money and contracts based on a minor's lies about his or her age. Minors attain capacity when they reach the age of seventeen (majority), and incapacitated adults can attain formal legal capacity through the courts once they are able to make rational decisions.

### **14. Relevant Civil Code Articles**

Article 63: Personality

Article 64: Legal capacity

Articles 118-125: Legal condition of minors

Articles 126-129: Age at which one stops being a minor and emancipation

Articles 130-143: Interdictions

Articles 144-148: Incapacitation

Article 153: Capacity

Article 248: Accidental incapacity

Article 273: Usurious interest-bearing transactions

## 15. Examples and Discussion Questions

### Example 1

Mariana, an adult, negotiates a contract to sell a scooter to João, who Mariana believes is eighteen years old. João heard Mariana speaking with a friend on the phone, explaining that she had to go because she was about to sell her scooter to a university student. Still only in high school, João worries that, if Mariana finds out his age, she will not go through with the scooter sale. Mariana never asked him his age, and João never informs her that he is really only sixteen years old. Instead, he rushes through the paperwork to avoid revealing his age, and signs the contract for the scooter. The deal states that he should pay in five payments with interest. Happy to have the new scooter, he speeds around the neighborhood to show off to his friends. João's mother quickly hears about the sale, and is angry that João spent all his savings on the scooter without first discussing the idea with her. She asks the court to invalidate the contract so that Mariana would have to return the money to João.

### **Discussion Questions**

1. What should the judge do according to the articles on legal capacity?
2. Should João have to return the scooter in exchange for his money?
3. What do you think is the fair result?
4. Was João deceitful under Article 122 because he did not tell Mariana his age?
5. Would it matter if, to get a higher price, Mariana led João to believe that the scooter was newer than it actually was?
6. Would it make a difference if Joao's savings were a result of his part-time job over the summer?

### **Answers**

1. Article 122 states that a minor who lies about his age cannot annul the contract based on his own lack of capacity. . The reasoning behind this provision is that minors should not benefit from deceiving others about their age. So, if Joao was the one requesting the annulment, a judge probably would ask for more information to assess whether it was reasonable for Mariana to

assume that João was in college or if she had a duty to inquire more into his age. If the judge finds that João purposely misled Mariana, then the judge would not annul the contract.

In the fact pattern given, however, it is João's mother who seeks annulment. According to Article 121 (1) (a), she is entitled to do so. Based on Joao's lack of legal capacity, the judge should then annul the contract under Article 119.

2. If the contract is invalidated, the exchange should be reversed. So João would get his money back and return the scooter to Mariana.

3. There are strong arguments on both sides. Annulling the contract protects João from risky deals when he might not understand the risks. But it is possible that João was not completely honest. Maintaining the contract based on his misleading Mariana would allow him to keep the scooter against his mother's wishes. Even if there is not a legal solution, there may be an education or corrective solution at home to teach João to be more careful in his financial decisions.

4. João seems like he did not blatantly lie though he wanted to mislead Mariana. A judge probably would need more facts to reach a final conclusion.

5. A judge might find that this was an unjust contract under Article 273 because Mariana took advantage of João's inexperience and youth. If the judge determines that Mariana was getting an unfair benefit by taking advantage of João, then the judge could annul the contract under Article 273.

6. If the money João used to pay the bicycle was a earned by his own work, there would be no grounds of annulment. Article 123 (1) (c) carves out an exception in that regard.

### Example 2

Aitana and Jose's adult son, Ramiro, has a mental disorder. He is unable to live without their daily assistance with meals and transportation. Ramiro's family has never requested his interdiction or incapacitation before a court. Ramiro wants to be more independent, so sometimes he sneaks out to the market alone. Aitana and Jose always worry for his safety, since he usually gets lost and neighbors have to help him get home. One day Ramiro takes money from his mother's bag and leaves to buy her a gift. Ana, who sells electronics at the market, notices that Ramiro is intrigued by a fancy new radio. Since he seems naïve, she increases the price a little. Not knowing any better, he spends all his mom's money on the overpriced radio. His mother Aitana asks the court to force Ana to give her the money back.

### Discussion Questions

1. Does it matter that Ramiro has not been interdicted/incapacitated yet?
2. Do you think that Ramiro lacked legal capacity?
3. How would Ana have known that he lacked capacity?
4. If he lacked legal capacity, would Ana have to repay Aitana?
5. Would Ramiro have to return the radio to Ana?

### Answers

1. If Ramiro was interdicted or incapacitated, Aitana would have undisputable grounds for annulment. As we have seen, legal transactions that are concluded while an interdiction/incapacitation action is pending or after it is definitely granted are annulable (TLCC Article 140 and 141). These Articles do not apply if the legal transaction happens before or in the absence of such proceedings. The judge will then have to rely on accidental incapacity, per Articles 142 and 248.
2. Ultimately it is a court's responsibility, with the assistance of background information from his family, to determine if Ramiro lacks legal capacity. Since Ramiro is not interdicted/incapacitated, Article 142 applies, demanding the court to look for accidental incapacity (Article 248). If he is unable to care for himself, a court likely would find that he lacks legal capacity under Article 248, since he does not seem to have free exercise of his will.
3. It is possible that courts might find that, given reasonable warnings, parties would have a duty to find out if the person has the capacity to make legal agreements. In that case, since she noticed that Ramiro might have had some mental problems, maybe Ana had the responsibility to see if he seemed able to make big decisions.
4. If the court found that Ramiro lacked legal capacity, the contract would be annulled under Articles 64, 142 and 248.
5. If a court declared the contract invalid for lack of capacity under Articles 64, 144 and 248, then a court likely would require the parties to reverse the transaction and require the parties to return the radio and payment.

### III. OBJECTS OF LEGAL TRANSACTIONS

#### 1. Overview of Objects within the Context of Contract Formation

##### SECTION OBJECTIVES

- To understand that it is important to identify the objects of transactions when forming contracts.
- To explore the effects of particular types of objects on contract formation.

##### *What is a contract object? Why is it important to identify the object of a contract?*

A contract's object is the thing that is to be legally affected by the perfection of that contract. In the context of sales contracts, contract objects are the things that will be legally transferred from the buyer to the seller. In the context of loan contracts, contract objects are the funds to be temporarily transferred from the creditor, who loans the money, to the debtor, who receives the money that must be paid back. In other words, a contract object is the thing about which a contract is made.

Identifying the object of a contract is important because a contract's object determines the rights and responsibilities of the parties to the contract. For example, a contract for the sale of a particular car creates a legal responsibility for the seller to convey that car to the buyer. It also creates a right for the buyer to gain ownership of the car. While this sounds simple, identifying the object of a contract can be difficult. What happens, for example, if a contract's object has accessories, or additional things attached to it that are not necessary for it to be a car? Are the accessories considered part of the object? Article 201(2) provides the answer to this particular question, which is that "[l]egal transactions whose object is the main thing do not include accessories, unless otherwise stated." This issue is discussed in more detail below, but what is important to realize here is that this is just one of the many legal issues that can come up in determining the object of a contract. Identifying a complex contract's object can require understanding a large number and variety of legal issues.

Since Timorese law limits the type of things that can be the objects of contracts, identifying a contract's object is also important for ensuring that the contract is enforceable. If a contract's object is a thing that it is not legal to contract about, the contract will be void and unenforceable.

What legal rules govern contract objects?

Article 193

Concept

1. Things are all that can be the object of legal relationships.
2. However, all things that cannot be the object of private rights, such as those found in the public sphere and those whose nature renders them impervious to individual appropriation, are considered to be outside the commercial circle.

Article 194

Classification of Things

Things are immovable or movable, simple or composed, fungible or non fungible, consumable or non consumable, divisible or indivisible, essential or accessory, present or future.

Article 271

Requirements Concerning the Object of the Transaction

1. Any legal transaction whose object is physically or legally impossible, against the law or undeterminable shall be void.
2. Transactions contrary to public order, or offending morality, shall be void.

According to Civil Code Article 193, only “things” can be contract objects. Anything that cannot be the object of private rights cannot be the object of contracts either. Such things are considered, “outside the commercial circle.” Article 193 provides some examples of things that cannot be the object of private rights, though there are other things that also can’t be the object of private rights that are not included in the article. The things mentioned in Article 193 are things “found in the public sphere and whose nature renders them impervious to individual appropriation.” This includes, for example, palm trees on public property because they are “in the public sphere.” This also includes public palm trees because they are large objects attached to, and part of, public lands which means that their “nature,” or their characteristics, properties, and attributes, make them impossible for an individual to appropriate, or get ownership of.

Article 271 puts additional limitations on the types of things that can be the object of contracts in Timor-Leste. According to this article, “[a]ny legal transaction whose object is

physically or legally impossible, against the law or undeterminable shall be void.” Here when the law says “undeterminable,” it means where it is not clear which object the contract was talking about. How could the law enforce a contract where no one is sure what the agreement was about? For example, if a buyer makes a contract with a large car dealership to buy “a vehicle” for a certain amount of money, but it is not clear to anyone from the contract which vehicle the contract is talking about, the contract is void. That is because the dealership has lots of different types of vehicles in different conditions and with different values, so it is necessary to know which vehicle is the object of the contract. It is therefore very important for a lawyer to make sure that the object is clear when writing a contract.

Contracts “contrary to public order, or offending morality” are also void under Article 271. To understand the effects of this legal rule, imagine that two unethical businessmen attempt to make a contract for the sale of illegal drugs. Since the contract’s object, illegal drugs, is against the law, a court would deem the contract void and it would have no legal effect. The businessmen would not have any legal obligation to one another.

A variety of other Civil Code articles set limitations on the types of things that can be the object of particular types of contracts. For example, Article 622 mentions six types of things that can be the object of mortgage contracts. Additionally, several articles contain legal rules that only apply to contracts with particular types of objects. For example, Article 872 applies only “[i]f the contract has as its object a thing in transit” meaning that the object of the contract is at the time being transported or shipped.

Article 193 also relates to contract objects. It provides a framework for classifying things. According to this article, things can be classified as “immovable or movable, simple or composed, fungible or non fungible, consumable or non consumable, divisible or indivisible, essential or accessory, present or future.” Because each of these terms is important and has different meanings in the law, they will each be described below.

*Immovable and movable:* Here “immovable” objects would include things that cannot be transported from place to place such as land, large trees, and big buildings. “Movable” objects would basically include everything that can be moved from one place to another such as cars, paintings, computers, etc..



*Simple and composed:* “Simple” objects are objects made up of one single part, like a stick or a horse. “Composed” objects are objects that are made up of many different pieces put together like a car or a factory with equipment.

*Fungible and non-fungible:* “Fungible” is a word which means an object that is not unique and can be exchanged for another of the same object without it mattering. For example, a painting is not fungible because it is very unique and one painting isn’t just as good or just as valuable as another painting. They don’t look the same, and since it is how they look that matters, they are all unique and not equally tradable one for the other. However, money is very fungible because it doesn’t really matter “which money” you have but how much money you have. Most people don’t care if they have one five dollar bill or another five dollar bill because you can substitute, trade, or exchange any other five dollar bill for another one without the value changing. Other things that are very fungible include things like rice, sand, and gasoline where people do not really care which particular grains of sand or rice they have, or which liter of gasoline goes in their engine, they only just care about how much they have. Normally someone can trade another person the same amount of rice for the same amount of the other persons and the other person doesn’t really mind. Most of the time with contracts involving fungible things, people want a certain quantity of the object, but don’t care about where it comes from or if it is the same exact pieces of the object that they let the other party borrow earlier. When a friend borrows a dollar from you, you do not expect that same dollar back and you do not care when you get a different dollar back; they are the same to you. Examples of objects that are non-fungible are things like a specific book, car, or photograph. Most of the time people care a lot about having a specific book, car, or photograph and they don’t feel that any different book, car, or photograph is the same as any other one and equal if traded. If someone borrows a photograph from someone, the person it was borrowed from will likely be very unhappy if the person doesn’t return that same specific photograph, but instead just gives the person a different photograph of something else back instead. In contracts involving non-fungible objects, the parties have a specific object in mind and not just a quantity; while they have a quantity in mind with fungible objects. Knowing whether an object is fungible or not is important because it often determines the legal rights that people has to the object, and the way that the court will enforce those legal rights. For an example, imagine if two people made a contract for 50 kg of rice to be delivered to the buyer, but the seller who was supposed to deliver the rice to the buyer breached the contract

and instead delivered the rice to a different person. In this case the judge is likely to say that the person who breached must either deliver a different 50kg delivery of rice or else pay the buyer the cost that the buyer had to spend to get 50 kg of rice from a different rice seller. Because rice is fungible, the court doesn't mind where the rice comes from, just how much the breaching party owes. Now imagine that instead two people made a contract, and a public deed, for the sale of one hectare of land, but then the seller breached the contract and did not let the buyer have the land. In this case, the court is likely going to require that the seller not just pay the buyer enough money to buy a different hectare of land somewhere else, but is instead going to require that the seller give that specific piece of land to the buyer. The reason for this is that land is not fungible. Land is unique and it is all different. People do not think that one hectare of land in one place is just the same as one hectare of land somewhere else. The difference between the legal results in the case of the rice and in the case of the land is caused by the fungibility and non-fungibility of the objects of the contracts. Because rice is fungible, the court will likely award a remedy, or solution to the legal dispute, that comes in the form of enough money to buy the same amount of rice from somewhere else. But in the case of land, the result is different because land is non-fungible. In the case of a non-fungible object like land the court will award a remedy that requires the seller to give the specific land in dispute to the buyer.

*Consumable and non-consumable:* A consumable object is an object that can be used until it disappears or loses all value, either by being eaten, burned, or in some other way having its value taken away. Consumable objects include food, drinks, fuel, soaps, and similar things. Non-consumable objects are objects that do not disappear like land or a painting. Whether or not an object is consumable is often important because it helps determine how the court decides on remedies and what that means for rights, especially because consumable things tend to get consumed and to disappear very quickly. This means that by the time the court is making a decision about what remedy it should give for breach of contract, the object is likely to be gone, and so the court is more likely to award money damages than the specific return of the object. This category of objects based on being either consumable or non-consumable, provides a good opportunity to discuss how all of these categories of objects are not always very clear. Sometimes one object is not very clearly one way or another, but instead has some of the properties of both categories. For example, something like a car is a little bit consumable and a little bit non-consumable. It is consumable because driving a car wears it out and causes it to get

damaged. You can only drive a car so many thousands of kilometers before it breaks down and is “consumed” or used up. That is because its value disappears over time the more it is used. But it is not completely consumable because it is not like driving the car makes it disappear. Even after the car has been driven many hundreds of thousands of kilometers, it still exists and so has not really been “consumed.” In this case, a court will have to consider how much the object is like an object that is consumable, and how much it is like an object that is not consumable. The same thing is true about other types of categories. For example, something like a horse is not really fungible, but it is also not really non-fungible either. A horse is a little bit fungible because most of what you do with a horse, riding it, using it for some types of work, you can do with almost any horse. It is also not fungible because each horse is different to ride and is good or bad at different things. Also, people become emotionally attached to their horses when they have had them for a while. So most people do not really feel that it is the same thing to trade one horse for another because they are not all equal, but also because they are not all very different, it is not too different to trade one horse to another if they are around the same age and size. In a case with a horse then, a court might have to make a difficult decision about whether or not someone can instead trade a different horse, of similar age and size, for a horse that they did not trade when they broke a contract. This is difficult because the court will have to decide if two horses are more fungible, or more non-fungible for these legal purposes.

*Divisible and indivisible:* Some objects, like a bag of rice or a tank of gasoline, are divisible and can be divided up into many pieces without each piece losing its value. For example, if you have a container of two liters of gas it is worth a certain amount of money. If you then take those two liters of gas apart by putting the gas into two one liter containers, you still have gas worth the same amount of money. Other objects are indivisible and lose their value when they are split into pieces. If you divide a horse in half, it is worth far, far less than it was worth when it was together in one piece. The court needs to consider this when trying to make “equitable” decisions, or decisions based on fairness. For example, if two parties have a dispute over a shipment of rice that was the object of a contract, and each thinks that they should get all of it, it is possible that the court can decide that they should divide it between them in some way. However, if two parties have a dispute over a boat that was the object of a contract, the court cannot decide that they should cut it in half and that they should each get half, since that would

destroy wealth and would not be good for anyone. When an object is indivisible, the court ultimately needs to decide what one party gets the object. Sometimes the court can make this decision less severe for the party who doesn't get the object by saying that the party who did get the object has to pay some money to the party who did not get the object, but it is still the case that not getting the object is not the same thing as money. A better example of when this can be a serious issue, is when the object of the contract is very non-fungible, like an old family bible. Both parties may value it highly for emotional reasons in a way that is not really easily traded for money. In that case the court will still have to decide who gets the family bible, and who maybe only gets money instead. This can make cases with indivisible objects much more difficult to solve than cases with divisible objects, especially when both parties have a good argument for why they deserve the object. When both parties have very good or equally good legal arguments for why they deserve a shipment of rice the court can just divide it to be fair. When both parties have very good, or equally good, legal arguments for why they deserve the family bible, the court cannot as easily provide a fair solution.

*Essential and accessory:* An essential item is an item that is necessary to a complex, composed object. For example, if I sell you a car, but then you find out it doesn't have an engine, you can argue that I have not really sold you a car, because for a car to be a car it must have an engine. An accessory item is a part of a complex, composed object that is not necessary for that object. For example, if I sell you a car, and it doesn't have a radio, you cannot make a good legal argument that I did not really sell you a car, because without a radio a car is still a car. The difference between an essential item and an accessory item is very important in contract law. It is very important because when a contract for the sale of a composed object does not specifically mention accessories as being included, the rule is that they are not included. But in the sale of a composed object, unless the contract says an essential item does not need to be included, all essential items must be included. This means that when one party sells another party a car, the car must have wheels, an engine, a transmission, and other things that are necessary for a car to be considered a car. But when one party sells another party a car, unless the contract specifically says that accessories are included, the car does not need to include a radio, a cigarette lighter, a clock, or any other thing not necessary for a car to be a car.

*Present or future:* This category is pretty obvious. A present object is an object that exists at the current time. A future object is an object that does not yet exist but that should exist in the future. Examples of future objects include anything that needs to be built or done in order to come into existence. Because the future is always uncertain, some future objects may never come into existence at all. These categories are mostly important for considerations of things like specific performance. If an object already exists it is much easier for the court to award that specific object than if the item does not yet exist; since it might never come to exist. This is especially true in a conflict between parties when one party may not ever be willing to make an object that was supposed to come into existence. For example, a court might not ever be able to give the remedy of specific performance in cases where the person they are trying to force to perform is refusing to, even after facing punishment for this refusal. In that case, the future object will never exist.

#### Relevant Civil Code Articles

Article 193: Concept

Article 194: Classification of Things

Article 271: Requirements Concerning the Object of the Transaction

#### Examples and Discussion Questions

##### Example 1

Lizia Sarmiento and Noy Anan are friends. They are sitting on the beach one day, looking at the sunset, and Lizia asks Noy if she can buy Noy's boat. Noy replied, "of course you can; and I'll even sell it to you at a discount—just 100 US dollars." Lizia was so overjoyed that she completely forgot to clarify which accessories would be included with the boat. In other words, she forgot to define the precise object of the verbal sales contract.

#### **Discussion Question**

Imagine that Lizia has come to you for legal advice. She wants you to help her identify the object of her contract with Noy. She explains that there are several fishing nets, an anchor, and two oars on the boat. She would like to gain ownership of all of these items. As Lizia's lawyer, how are you going to advise her? Does she have a legal right to the nets, anchor, and oars?

### Answer

The nets, anchor, and oars Lizia mentioned are all “accessories” within the meaning of article 201 of the Timor-Leste Civil Code. In the words of this article, they are “movable things that, without being integral parts of the main thing, are at its service or ornamentation in a lasting manner.” As mentioned earlier, article 201 of the Timor-Leste Civil Code sets forth the legal rule for determining whether accessories are considered as part of a contract’s object. The rule is that “[l]egal transactions whose object is the main thing do not include accessories, unless otherwise stated.” Therefore, since Lizia and Noy did not state that the accessories would be included with the boat, you should advise Lizia that she is unlikely to have a legal right to the accessories. If Lizia is willing to fight a legal battle, however, she might be able to argue that at least the anchor is not an accessory, and is actually a part of the contract object, because it is an “integral part” of the boat. However, whether or not the anchor actually is an “integral part” of the boat would be up to the decision of the judge.

## 2. Declarations of Willingness

### *Overview of Declarations of Willingness in Contract Formation*

#### SECTION OBJECTIVES

- To understand that declarations of willingness can be express or implied, and that they can be indicated by silence in certain situations.

#### *What is a declaration of willingness?*

At the most simple level, a contract is formed when two parties make declarations of willingness to be bound by a contract. A declaration of willingness is a statement that the parties are okay with being bound by the contract, and is thus an indication of a party’s willingness to undertake certain legal obligations, under certain legal terms. However, as we shall see in subsection V on willingness and will-related faults, declarations of willingness can fail to form a legally enforceable contract if the parties making the declaration lack actual willingness to be contractually bound.

#### *What are the different types of declarations of willingness?*

The Timor-Leste Civil Code explains the different types of declarations of willingness in Articles 208 and 209:

Article 208

Express Declaration and Implied Declaration

1. A business declaration can be express or implied: it is express when made by words, in writing or by any other direct means of expressing intention; it is implied when it is deduced from facts that reveal it in all probability.
2. The formal nature of a declaration does not prevent it from being issued in an implied manner, provided that the form regarding the facts from which it is deduced has been observed.

Article 209

Silence as a Means of Declaration

Silence is valid as a business declaration if it is granted this value by law, usage or convention.

Let's go through the different types one by one:

Express Declarations

An express declaration of willingness is one made via oral or written communication, including electronic communication, where a party explicitly and clearly tells another party that he is willing to undertake certain contractual obligations under certain conditions. In legal disputes, an unambiguous express declaration can serve as excellent evidence of the actual terms and conditions of the contract.

Implied Declarations

Implied declarations of willingness, on the other hand, are not explicitly stated or written. Implied means something that is supposed to be understood, but that is not clearly said. Instead, the existence of implied declarations of willingness is deduced, which means it is reached as a conclusion by looking at all of the facts and thinking about them. Implied contracts are deduced, first by the contracting parties and later by the courts. For example, imagine that a young man has a severe accident on a motorcycle and has to go to the hospital. Do you think that the doctors will wait to treat the man until a contract for medical services has been negotiated? Probably not. Instead, the two parties operate under an implied contract, both deducing their obligations from the facts of the situation. The fact that the young man entered the hospital seeking services,

knowing that payment is required for those services, indicates that he is willing to pay for the medical services he receives. The fact that the hospital routinely treats patients for a reasonable, predictable price indicates that the hospital is willing to continue this pattern. The injured man does not have to tell the doctor in advance that he agrees to pay for the treatment, and the doctor doesn't have to tell the young man in advance that he will charge him for the treatment. They both are agreeing to these terms implicitly, without actually stating them. If the young man refused to pay or if the hospital charged 1 million US dollars for the services, the court would probably find that a contract, formed by implied declarations of willingness, had been breached.

While implied declarations are just as valid as express declarations, their existence can be difficult to prove in court. The exact terms under which the implied declarations have been formed are even more difficult to prove. For this reason, it is better to make express declarations of willingness whenever possible. The only times it is okay to rely on implied contracts is when there is an exceptional reason to, such as an emergency like in the case of a motorcycle accident, or when it is a very common and routine custom, such as eating at a restaurant and paying afterward.

#### Silence as a Means of Declaration

Article 209 of the Timor-Leste Civil Code states that “[s]ilence is valid as a business declaration,” under certain circumstances. In some cases, the law might explicitly state that silence can serve as a declaration of willingness. For an example of this, read the following articles from the Civil Code:

#### Article 1077

##### Concept

A mandate is an agreement whereby one of the parties undertakes to practice one or more legal acts on behalf of another party.

#### Article 1083

##### Tacit Approval of the Implementation or Non-implementation of the Mandate

Once the implementation or non-implementation of the mandate has been announced, silence on the part of the principal for a time longer than that required to give his or her opinion, according to normal custom or in their absence, in accordance with the nature of the matter, means the approval of the conduct of the agent, even though this may have exceeded the



limits of his or her mandate or have ignored the instructions of the principal, unless otherwise agreed.

Article 1083 states that silence can be a means of declaration in contracts involving mandates. A mandate is a relationship between two people called an agent and a principle. The agent is a person who acts on behalf of the principle, and has to do what the principle tells them to do. The principle is someone who has an agent who they are able to tell what to do on certain matters. In a mandate, the agent is legally obligated to act on behalf of the principle in certain ways. When there is ambiguity in the scope of an agent's mandate, meaning that it is unclear what type of things an agent is allowed and supposed to do on behalf of the principle, an agent can clarify what it is they are supposed to and allowed to do simply by doing the things. This in effect acts as the agent's implicit declaration of willingness to do the things that they have started to do. If the principal stays silent and does not sue the agent for breach of contract for them doing these things, this serves as the principal's implicit declaration of willingness to be bound by the clarified contract terms. In many ways this is similar to an implied contract, in which it is implied that the principle would object to and try to stop what the agent is doing if they weren't implicitly agreeing to the agent doing it.

In other cases, "uses" or "convention" can indicate situations where silence is a valid way of making a declaration of willingness. To understand this concept, imagine that two brothers are both fishermen and one, Roberto, wants to borrow a net from the other, Amandio. Roberto is in a hurry so he rushes into Amandio's house, grabs the net, and yells to Amandio: "I'm borrowing your net. Stop me if you need it today." If Roberto gives Amandio enough time to tell Roberto that he needs the net today and that Roberto shouldn't take it before leaving the house, and if Amandio did not tell him that or stop him during that time, then Amandio made a declaration of willingness to let Roberto use his net through his silence.

Common situations where uses or conventions make silence a valid declaration of willingness include:

- When a party has a reasonable opportunity to reject offered services but does not reject them, that party's silence in not rejecting the services may serve as his declaration of willingness to pay for the services if he had reason to know that compensation was expected.

- When circumstances indicate that a party should tell her counterpart if she does not intend to make a declaration of willingness, silence may be interpreted as a declaration of willingness. Such situations can arise from previous dealings between the parties.

Relevant Civil Code Articles

Article 208: Express Declaration and Implied Declaration

Article 209: Silence as a Means of Declaration

**3. Form**

Overview of Form in Contract Formation

**SECTION OBJECTIVES**

- To understand that when a law prescribes the use of a particular form, it is requiring the use of a set of conventions, or required ways of doing things, that specify how a declaration of willingness is to be made.
- To explore the effects of form requirements on oral stipulations, or spoken parts of the agreement not written down, to declarations of willingness.

What does “form” mean in contract law?

In contract law, the word “form” refers to a set of conventions, which are required ways of doing things, which specify how a declaration of willingness is to be expressed. Often, the only convention is that the declaration be made in writing; this is the “written form.” Civil Code articles will mandate such a form by stating that a certain type of agreement “shall be entered into in writing” or using similar language. Specific forms for certain contracts will also be determined by the law. For example, Article 1016 requires rental contracts to be done in writing. Other forms, such as public deeds, require parties to follow conventions that are more complex.

What are the rules for form in contract law?

Article 210 says that “[t]he validity of a business declaration does not depend on the observance of a special form, except where the law so requires.” This means that contracting parties are free to make declarations of willingness, and thus contracts, without observing any legally prescribed form, if the Timor-Leste Civil Code has not specifically prescribed the use of a certain form for the types of declarations of willingness the parties are making. If, on the other

hand, a party is making a declaration of willingness that has a specific legally required form, Article 211 says that failure to use the legally prescribed form will normally make the contract null and void. There are exceptions to this though in some cases where not using the legally required form doesn't make the contract null and void, but instead provides a different sanction. To determine which types of contracts don't need a specific form, which ones do require a specific form or are invalid, and which ones require a specific form but aren't invalid if they fail to have that specific form, it is necessary to read and understand the statutes for each type of contract.

Read through Articles 210 and 211 and try to understand their meaning:

Article 210  
Freedom of Form

The validity of a business declaration does not depend on the observance of a special form, except where the law so requires.

Article 211  
Non-Observance of Legal Form

A business declaration which lacks the legally prescribed form is invalid, unless a different sanction is especially provided for by law.

Many common types of declarations of willingness have a legally prescribed written form. For example, purchases and sales of real property, meaning land, rental agreements, and large loan agreements all require a particular form. Read through the Civil Code articles in the box below and try to determine what legal form they require. Also, try to understand how each of the articles regulates a type of declaration of willingness:

Article 809  
Form

A purchase and sale contract for real property is only valid if entered into by means of a public deed.

Article 1016  
Form

1. The rental agreement shall be entered into in writing.
2. Unless otherwise stated in the provisions, the rent shall, despite absence of written deed,

recognised in court, by any other means of proof, when it is shown that the absence is imputable to the counterpart in the agreement.

Article 1063

Form

The loan agreement of a value higher than 2,500 US dollars shall only be valid if entered into by public deed and that of a value higher than 250 US dollars if entered into by document signed by the borrower.

How did you do? Let's go through the articles one by one.

Article 809:

This article regulates purchases or sales of real property. Since purchasing and selling are regulated in the same manner, let's focus on selling for now. When an owner of real property wants to sell his property, he must make a declaration of his willingness to do so. This requirement stems from the fact that contracts are voluntary agreements. A declaration of willingness is required to indicate that a party selling real property is actually willing to transfer his property rights. The laws of Timor-Leste prescribe a particular form for declarations of willingness to purchase or sell real property, presumably, in part, to protect third parties and guard against property disputes resulting from property being sold multiple times. The legally prescribed form is a "public deed."

Article 1016:

This article regulates rental agreements, which requires (1) a renter's declaration of willingness to temporarily transfer use of property to another, and (2) a tenant's declaration of willingness to pay for use of the property and to otherwise perform certain contractual obligations. The form required for rental agreements is for the agreement to be "in writing." However, if the plaintiff in a legal dispute over a rental agreement is the one that is at fault for the agreement not being in writing, the court may find that the agreement is nevertheless valid in order to protect the defendant since it was not his or her fault that it wasn't in writing.

### Article 1063:

This article says that loan agreements for amounts higher than 25,000 US dollars must be made in the form of a public deed. It also requires that loans of amounts higher than 10,000 US dollars be made in the form of a notarized written document signed by the parties. If the loan agreement is for amounts lower than 10,000 US dollars, a simple written document signed by the parties is enough.

### *Scope of Legal and Voluntary Form*

Determining the scope of the form requirements, meaning all of the topics in the agreement that need to be included in the form, is complicated. Oral parts of the agreement, called oral stipulations, that have not been written down but which clarify the details of the contract may or may not have to conform to the same form as the declarations. For example, imagine that you have made a written rental agreement where you agree to pay rent to live in a house on the condition that the owner of the house repairs some damage to it before you start to pay rent and move in. Let's say that you also talked with the owner and you both agreed about all of the specific repairs to the roof, electricity, and plumbing that he would do before you would move in and pay him rent. However, you never wrote what the specific repairs were in the rental agreement. You only wrote that the owner would "repair some damage". In this case, the spoken agreement about the specific repairs to the roof, electricity, and plumbing that you both agreed to is an oral stipulation that clarifies the meaning of "repair some damage" in the declaration of willingness. The question then is whether this oral stipulation is a binding part of the contract, or if, because it was not included in the written contract, it is not binding. Determining if it is binding or not is complicated and involves looking at many different issues or factors.

The following factors determine whether or not such oral stipulations must be of a certain form in order to be binding:

- Whether the form is legally prescribed, meaning it had to be done a certain way to be binding, or voluntary, meaning you decided to make the contract a specific way but that it didn't have to be done that way, like if the contract could have been oral but you decided to write it down anyway.
- When the oral stipulation was made with respect to the declaration of willingness in question. It matters if the spoken clarifications of the details were done before the

declaration of willingness form, at the same time, or afterward. For example, if the contract was written, did you clarify the details of the agreement before forming the written contract, while forming the written contract, or after the contract was formed?

- Whether the reason why the form is required applies to the oral stipulations. For example, if the reason why a certain type of contract has to be written is because we are concerned about people lying about the conditions they orally agreed to, then we probably think that all of the details had to be written down because someone could lie about the details, the same as they could lie about the conditions in the first place. But, if the reason why a type of contract had to be written down in a public deed was because we want the government to be able to know who owns what land for census reasons we probably do not mind if all of the small details of the conditions of the sale were not included in the public deed; the government doesn't need to know these details and so the reason for the form isn't being undermined or broken by not requiring all of the oral details to be included.
- Whether the oral stipulations can be proven to correspond with the intentions of the party making the declaration, meaning that the oral stipulations were intended to be considered part of the contract by the person making the declaration.
- Whether the law prescribes or requires a particular form for the oral stipulation in question.

Below are Civil Code Articles 212-213, which regulate the scope of legal and voluntary form:

Article 212  
Scope of Legal Form

1. Accessory oral stipulations prior to, or contemporaneous with, the document legally required for a business declaration, are invalid, unless the reason determining the form does not apply to them and they have been proven to correspond to the intention of the author of the declaration.
2. Stipulations subsequent to the document are only subject to the prescribed legal form for the declaration if the reasons for a special requirement in the law apply to them.

Article 213  
Scope of Voluntary Form

1. If the written form is not required by law, but has been adopted by the author of the declaration, accessory oral stipulations prior to, or contemporaneous with, the written matter are valid, when they have been proven to correspond to the intention of the declarant and the law does not subject them to a written form.
2. Oral stipulations subsequent to the document are valid, unless the law requires the written form for the purpose in question.

To begin determining whether a particular form is required for an oral stipulation, first determine whether the form of the relevant declaration of willingness was legally required or if it was not legally required but was done that way anyway (voluntary). For example, loan agreements for more than 25,000 US dollars are legally required to be made in the form of a public deed. So, in case the borrower of a 8,000 US dollar loan decided to use the form of a public deed, that form was chosen voluntarily and should not be binding to oral stipulations. . That means that when there is a mandatory form for the contract to be made in, the validity of oral stipulations will be governed by Article 212 of Timor-Leste Civil Code. When parties are free to choose a form, i.e. when the law does not require any specific form, the validity of oral stipulations will be governed by Article 213.

Legally Prescribed Form

Article 212 states that oral stipulations made “prior to, or contemporaneous with, the document legally required for a business declaration, are invalid,” unless two conditions are met. In other words, there is a presumption of invalidity for oral stipulations made before, or at the same time, of the declaration of willingness in the form prescribed by the law if such stipulations were not incorporated into the required form. Such presumption of invalidity can be overcome

by showing that both of the following two conditions, or requirements, have been met: (1) “the reason determining the form does not apply” to the oral stipulations in question, and (2) the oral stipulations “provenly correspond to the intention of the author of the declaration.”

To understand how this works, pretend that you are representing a party in a contract dispute involving the sale of real property. Your client in this contract sold land to the buyer who is the counterparty in the contract. Imagine that when the contract was formed, before the dispute arose, your client’s counterparty, the buyer, made an oral stipulation to the agreement as the two parties were walking into the notary public’s office to have the agreement signed. In this oral stipulation he said, “Even when I own the land, after I buy it from you, you still have permission to continue to grow coffee on the back half of the property.” This statement is not included in the written public deed. Later, the counterparty changes his mind, and decides that you do not have permission to continue to grow coffee on the back part of the land that he now owns. How do you convince a judge that the oral stipulation was a valid part of the agreement even though it did not conform to the form requirements for sales of real property, meaning that it wasn’t included on the deed?

First, you need to make an argument that the reason that the law requires contracts have this type of form, the public deed, does not apply to the oral stipulation. To do this, you must first discover the reason the form is required for the type of declaration of willingness in question. In other words, you need to discover the purpose of the requirement that purchases and sales of real property must be made by public deed. Once you know the purposes, you can argue that none of the reasons for the requirement are undermined, worked against, frustrated, or hindered by permitting the oral stipulation to be valid despite it not conforming to the form requirement.

To meet the second condition for overcoming the presumption of invalidity, you must prove that the oral stipulations the counterparty made “correspond to the intention of the author of the declaration.” In this case the author of the spoken declaration is the buyer who stipulated that your client could continue to grow coffee on the land. In other words, you must prove that the counterparty actually stated that your client could still grow coffee on part of the land and intended that statement to be binding. You must also prove that the counterparty was not joking, or did not otherwise have a different intention in making the oral stipulation. This can be difficult to prove.



On the other hand, oral stipulations that are made after the formation of agreements with a legally prescribed form are presumed valid. Such stipulations only have to take the prescribed legal form if “the reasons for a special requirement in the law apply to them.” In other words, as long as the oral stipulation doesn’t frustrate, hinder, or undermine the purpose of having a required legal form in the first place, any verbal agreements made after the formation of the contract are valid. If your client’s counterparty in the sale of land in the above example had made his promise to allow your client to farm coffee on the back half of the land after the legally prescribed form of making the contract had been completed and you could prove he made such an oral stipulation, it would be a binding part of the agreement unless the buyer could prove that it was against the reasons for the existence of the public deed requirement for the promise to be valid and binding.

### Voluntary Form

When the law does not require a written form, but the parties use a written form for an agreement anyways, oral stipulations made prior to, or at the same time as, the agreement are valid, as long as they “correspond with the intention of the declarant” and are not covered by other laws that require a written form. If the oral stipulations are made after the agreement, they are valid, “unless the law requires the written form for the purpose in question.”

Special Note: For more on voluntarily form, read Article 214 on conventional form, which is outside of the scope of this text.

### Article 214 Conventional Form

1. The parties may stipulate a special form for the declaration; in this case, it is presumed that the parties only wish to be bound by the conventional form.
2. However, if the form is only agreed upon after the transaction is concluded or at the moment of its conclusion, and there are grounds to admit that the parties wished to be bound from the start, the convention is presumed to have aimed at the consolidation of the transaction, or at some other effect, but not at its replacement.

### Relevant Civil Code Articles

Article 210: Freedom of Form

Article 211: Non-Observance of Legal Form

Article 212: Scope of Legal Form

Article 213: Scope of Voluntary Form

Article 214: Conventional Form

#### 4. Perfection of Declarations of Willingness

##### *Overview of Perfection of Declarations of Willingness in Contract Formation*

###### **SECTION OBJECTIVES**

- To understand how contracts are perfected.
- To explore the basic rules for perfecting declarations of willingness in contract formation.

##### *What does it mean to “perfect” a declaration of willingness?*

Contracts are made effective and become binding when they are perfected. To review, the term “perfected” is a legal term meaning three things: 1) that the parties have come to an agreement that they all understand all of the details and terms of without any misunderstandings, 2) that each party agrees to be required to fulfill their part of the agreement, and 3) that all formal legal requirements for contract formation have been met. Civil Code Articles 215-226 set of the rules for perfection of declarations of willingness. These articles also determine when parties are released, or freed, from their contractual obligations.

There are a few legal terms that you should be familiar with to understand the law of perfecting declarations of willingness. First, most contracts begin when one person or group proposes, or suggests, to another person or group that a contract be made. The person or group making the proposal is called the “proponent,” “offerer,” or “declarant.” The declaration of willingness made by the proponent is called a “contract proposal,” an “offer,” or a “declaration.” The person or group receiving the contract proposal is called an “addressee.” The declaration made by the addressee in response to the contract proposal is either an “acceptance,” a “rejection,” or an “acceptance with modifications.” Here is a diagram to help you remember these terms:

*How do you perfect a business declaration?*

For a declaration of willingness to be perfected, the rules contained in Articles 215-226 of the Timor-Leste Civil Code must be followed. Most of these articles address the issue of whether there has been a “meeting of the minds”. A “meeting of the minds” means that all of the parties to the contract understand all of the details of the agreement, without any misunderstandings, and that they agree to be bound by these details.

The reason it is difficult to determine whether there has been a meeting of the minds is that parties do not always form contracts face-to-face. Because of this, they may not understand all of the details of the agreement because they didn’t get to talk about all of the details. For example, some contracts are made through the mail or over e-mail. Moreover, an addressee may respond with an acceptance but with modifications to some of the details that the first contract never had and that the other person never agreed to. Normally, an acceptance that changes some of the terms of the contract is not legally considered a real acceptance. For example, if a car salesman makes an offer to sell a car for 500 US dollars, the addressee may respond by saying that he is willing to pay 450 US dollars. The effect of this price adjustment is that the addressee has not accepted the car salesman’s offer because his acceptance with modifications does not count as a real acceptance. Offer and acceptance are important concepts when it comes to the perfection of a contract and you should always pay close attention to the moment when the offer was made and if and when it was accepted, rejected or modified.

Since Articles 215-226 set forth complex rules for determining whether a contract has been perfected, let’s go through each article one-by-one:

## Article 215: Efficacy of Business Declaration

### Article 215 Efficacy of Business Declaration

1. A business declaration which has a specific addressee produces effect as soon as it reaches him or he is informed of it; other business declarations come into effect as soon as the declarant's intention is expressed in the appropriate form.
2. A declaration which was not timely received by the addressee solely to his or her own fault is also considered to have come into effect.
3. A declaration received by the addressee in such a state that it cannot be understood, and due to no fault of his or her own, produces no effect.

In the context of contract formation, Article 215 explains when a contract proposal is deemed effective. There are several reasons why this is important. First, after a contract proposal has been made, the addressee has a limited amount of time to accept the proposal. While the length of this time period varies, it almost always begins when the proposal becomes effective. The second reason Article 215 is important is that contract proposals are sometimes considered legally accepted if the addressee does not issue a rejection within a certain period of time after the proposal produces effect. Thus, it is important to know when the offer is effective.

Article 215(1) explains that an offer with a specific addressee becomes effective as soon as it reaches that addressee, or as soon as the addressee is informed of the offer. For example, if a proponent leaves a contract proposal attached to an addressee's front door, that proposal becomes effective as soon as the addressee comes home and finds the proposal. Offers without specific addressees, on the other hand, "come into effect as soon as the declarant's intent is expressed in the appropriate form." To understand this rule, it is necessary to understand how offers can be made without a specific addressee. The main ways this can occur are: (1) when offers are made to the general public, and (2) when the specific identity of the addressee is unknown. In either case, Article 216, which we will cover next, provides the rule for determining whether the declarant's intent has been expressed in the appropriate form.

Since the date at which proposals become effective is often determined by when the addressee receives the proposal, it is important to make sure that an addressee is not permitted to use this rule unfairly to his own advantage. This is exactly what Article 215(2) does—it prevents addressees from benefiting when they are at fault for a delay in the receipt of a proposal. In other

words, if an addressee purposefully delays receiving an offer until a particular time, courts will consider the offer to have come into effect when it should have been received, instead of applying the basic rule from Article 215(1).

Article 215(3) addresses the problem of offers that cannot be understood. This can occur, for example, if the offer has been written in bad handwriting, or if the offer has been exposed to rain, making even good handwriting unreadable. Also, since some contracts can be made orally, this can occur if the offerer is speaking a language the addressee cannot understand. In any case where an addressee receives a contract proposal that they cannot understand, for reasons that are not their fault, the proposal produces no effect. It is also important for the addressee to have an understandable offer, otherwise he or she would not be able to provide evidence that such an offer was made.

#### Article 216: Public Announcement of Declaration

Article 216  
Public Announcement of Declaration

A declaration may be made through an announcement published in one of the newspapers of the residence of the declarant, if addressed to an unknown person or to someone whose whereabouts are unknown to him.

Sometimes, a proponent does not have a specific addressee in mind in making a contract proposal. A common example of this is an advertisement offering to sell a product at a particular price. Article 216 facilitates such advertisements, and other offers without specific addressees, by allowing proponents to make offers through newspapers. Article 215(1) makes offers printed in newspapers effective as soon as they are published.

## Article 217: Death, Incapacity or Incidental Unavailability

### Article 217

#### Death, Incapacity or Incidental Unavailability

1. The death or incapacity of the declarant after the declaration is issued does not jeopardize its effect, unless the contrary results from the declaration itself.
2. The declaration is ineffective if, while the addressee does not receive it or is not informed of it, the declarant loses the power to dispose of the right it refers to.

What happens if the proponent or addressee dies or otherwise becomes unable to personally fulfill the obligations of the contract? Article 217 addresses this issue. Article 217(1) explains that if the proponent, or declarant, dies or becomes incapacitated after the contract proposal is issued, the proposal is nevertheless effective. For example, if the declarant had made an offer to sell her boat before she unexpectedly died, the addressee could still accept the offer and the testator of the declarant's estate, who is the person legally in charge of giving away the dead woman's things after she dies, would be legally required to sell it at the price that was in the original offer. The exception to this rule is that the proposal, or declaration, itself can prohibit this result. If the declaration prohibits the offer from staying valid if the declarant dies or becomes incapacitated, the law will respect that and the offer will become invalid. Thus, the boat seller could have included a clause, or term, in her proposal explaining that the proposal would stop being effective if she were to die prior to the addressee accepting the proposal.

Article 217(2) explains what happens if the declarant loses the ability to perform as he proposed before the addressee receives or is informed of the proposal. In such cases, the declaration never becomes effective.

## Article 218: Fault in the Formation of Contracts

### Article 218

#### Fault in the Formation of Contracts

1. Whoever negotiates with another for the conclusion of a contract should proceed, both in the preliminaries and in its formation, in accordance with the rules of good faith, under penalty of having to answer for the damage culpably caused to the other party.
2. Responsibility ceases under the terms of Article 432.

Article 218(1) requires parties to negotiate in good faith, meaning without any bad intentions such as an intention to trick the other party, while in the process of creating a contract. The penalty for failure to meet this requirement is liability for damage caused to the other party. For example, if someone sells you a phone in Colmera, and they know that the phone doesn't work, the contract is void and the person selling the phone owes you your money back as well as any other damages caused to you by having a broken phone. Article 218(2) sets the limits on the amount that a party acting in bad faith can owe the other party, and for how long they can owe the other party, by referring to Article 432 which covers these issues.

#### Article 219: Duration of the Contractual Proposal

Article 219  
Duration of the Contractual Proposal

1. A contract proposal binds the proponent in the following terms:
  - a) If a deadline for acceptance has been established by the proponent or agreed by the parties, the proposal remains open until this time expires;
  - b) If no deadline is established, but the proponent requests an immediate answer, the proposal remains open until, in normal conditions, both proposal and acceptance reach their destination;
  - c) If no deadline is established and the proposal is made to a person who is not present, or in writing to a person who is present, it will remain open until five days after the deadline set in the preceding subparagraph.
2. The provisions established in the previous paragraph do not prejudice the right to revoke a proposal under the terms in which revocation is admitted in Article 221.

Article 219 explains the rules for determining how long the addressee has to accept the offer before the offer expires and it is no longer possible to accept. A good understanding of these rules and how they operate is important for proponents to identify the duration of their offers, and for helping addressees to identify how long they have to accept. Article 219(1)(a) simply states that the proponent can set a deadline for his offer to be accepted, or the parties can agree to such a deadline. This deadline preempts, meaning that it has priority over, any deadline set by law. That means that if the person making the offer says how long the other party has to accept, that is how long the other party has to accept, regardless of what the law says. This rule is

this way because the law wants people to be free to make their own contracts the way that they like whenever it is not damaging for them to do so. The general policy is that there is freedom of contract except when there is an important reason to limit contracts. The law understands that some circumstances require longer offers and others require shorter offers, and so the law is designed to be as flexible as possible. The reason that the law has any set length that is normal when there isn't an agreement that gives a different length is because it recognizes that sometimes people will forget to include how long an offer stays open, and even when they forget to include this it is not fair for the offer to stay open to acceptance forever.

Article 219(1)(b) states that, if no deadline is established, but the proponent requests an immediate answer, the proposal should remain open until the reasonable time for the proposal to reach the addressee and for the acceptance to reach the proponent expires. That means that if an offer is sent through post mail, you should count the number of days the letter would take, under normal conditions, to reach the addressee and add them to the number of days the acceptance would take to reach the proponent, by post mail, also under normal conditions. In other words, the proposal is open during a reasonable estimate of time for it to reach the addressee and go back to the proponent. However, if the conditions in which the proposal and acceptance are being delivered are not "normal conditions," then the court may find that the deadline for acceptance is different from the one that would be estimated under normal conditions.

Article 219(1)(c) provides the last rule for determining the duration of the contract proposal. It states that, if no deadline is established and the proposal is made to a person who is not present, or in writing to a person who is present, then the proposal remains open until five days after the reasonable estimate of time mentioned in the previous paragraph. The one exception to these rules is explained in Article 219(2), which permits proponents to revoke their contract proposals in accordance with Article 221.



## Article 220: Late Receipt

### Article 220 Late Receipt

1. If the proponent receives acceptance of the offer belatedly, but has no reason to admit it was sent past the proper time, he must immediately warn the acceptant that the contract was not concluded, under penalty of being liable for the damage caused.
2. However, the proponent shall consider a belated reply effective, provided it was sent in a timely manner; in any other case, the formation of the contract depends on a new proposal and a new acceptance.

If an acceptance is late in reaching the proponent, the effectiveness of the acceptance depends on whether it was sent in a timely manner, meaning quickly enough, or before the deadline established by Article 219. To understand this rule, it is helpful to read Article 220(2) before Article 220(1). That is because Article 220(2) says that even if the acceptance was sent late, if it was sent quickly enough, it should normally be considered effective. Article 220(1) says that if the acceptance was sent after the deadline and the proponent does not see any good reasons for such a delay to have occurred, he or she does not need to accept this late response. The proponent needs to let the addressee know that he received the offer too late and that therefore the contract was not formed. If he doesn't warn the addressee that the contract was not formed, he might owe the addressee money if the addressee, because the addressee thinks the contract was formed, does anything that causes himself damage. Finally, if the addressee sends an acceptance but not in a timely manner, meaning that he waited for too long before replying, then the reply is ineffective and a new proposal and new acceptance must be made before a new contract can be formed.

## Article 221: Irrevocability of the Proposal

### Article 221 Irrevocability of the Proposal

1. Unless otherwise stated, the contract proposal is irrevocable after being received by the addressee or after he is informed about it.
2. However, if at the same time as the proposal, or before it, the addressee receives the

proponent's recantation or is otherwise informed of it, the proposal loses its effect.  
3. The revocation of the proposal, when addressed to the public, produces effect as long as it is made in the form of an offer or in an equivalent form.

Once a contract proposal is received by the addressee or the addressee is informed about it, the default rule, meaning the rule that applies unless it is changed in a permitted way, is that the proposal is irrevocable. Irrevocable here means that the proposal can't be canceled or changed in its terms without warning the addressee or addressees. However this default rule may be overridden if the proposal states that the proponent may recant, or cancel, it at any time. In this case the default rule no longer applies and the contract may be revoked at any time. In the default rule, before the contract proposal is received by the addressee or the addressee is informed about it, however, the proponent may recant, or say that they are revoking, the proposal so that it loses its effect. To clarify, this recantation must be received by the addressee, or the addressee must be informed about it, before the addressee receives, or is informed of, the contract proposal. If the addressee receives the contract proposal first, the recantation is unsuccessful. If the contract proposal was originally addressed to the public, Article 221(3) applies. Article 221(3) states that, in cases of proposals addressed to the public, the revocation produces effect as long as it is made in the form of an offer or in an equivalent form. So if offers of the type that was made must be made through a local newspaper, then the revocation must also be made through a local newspaper.

#### Article 222: Death or Disability of the Offerer or the Addressee

##### Article 222 Death or Disability of the Offerer or the Addressee

1. Contract conclusion shall not be affected by the death or disability of the offerer, save there are grounds to believe that his or her will would have been different.
2. The offer shall be deemed ineffective following the death or disability of the addressee.

Like Article 217, Article 222 deals with the issue of the death or disability of either the proponent or the addressee before a contract has been concluded. Article 222(1) is the same as Article 217 in stating that a contract's conclusion is not affected by the death or disability of the

proponent unless there is reason to believe that the proponent's will would have been different. So if we believe that the proponent would have wanted the conclusion of the contract to be affected by their death or disability, the court may decide that it should be.

The rule is different for the addressee than for the proponent. If the addressee dies or becomes disabled before the contract is concluded, the offer is deemed ineffective, by Article 222(2). The reason for this is probably that the proponent had enough opportunity before his death to consider the agreement he was writing and to decide if it was a good idea or else he would not have proposed it and that he or she chose to make the offer to this particular addressee, being unreasonable to oblige him to keep the same proposal to other people.

#### Article 223: Scope of the Understanding

Article 223  
Scope of the Understanding

No contract shall be concluded until the parties have agreed on every clause upon which agreement has been required by any party.

Article 223 simply states that no contract is perfected until the offerer and addressee have agreed on every clause, or detail, for which agreement has been required by any party. For example, if the proponent has required that an inflation rate must be set for a long-term supply contract, then that contract cannot be perfected until an inflation rate is set.

#### Article 224: Acceptance with Modifications

Article 224  
Acceptance with Modifications

Acceptance with additions, limitations or any other modifications shall mean that the offer is rejected. If however the modification is sufficiently precise it shall be considered a new offer, provided that a different meaning does not result from the declaration.

Article 224 explains that if an acceptance is made with any modifications, the reply is actually a rejection. This harsh result is meant to protect proponents from being bound by proposals different from the ones they issued and agreed to. Article 224 clarifies, however, that a sufficiently precise modification shall be considered a new offer, unless the initial proposal makes a different result more appropriate. For example, the initial proposal could state that certain modifications are permissible, and that acceptance with such modifications will serve to perfect the contract. In that case, treating the acceptance with modification as a new offer would be contrary to the intention of the proponent in making the contract proposal.

In other cases when there is an acceptance but with modifications, it functions as both a rejection and as a new offer to the original proponent, often called a “counter offer.” The original proponent, who is now the addressee of the counter-offer, now has the opportunity to accept the new offer, reject it, or to reject it but propose their own counter-offer again.

#### Article 225: Dischargeable Declaration of Acceptance

Article 225  
Dischargeable Declaration of Acceptance

Whenever the offer, the very nature of the transaction or its circumstances, or custom render the declaration of acceptance dischargeable, the contract shall be deemed concluded as soon as the conduct of the other party evidences intent to accept the offer.

When the nature of the proposal, of the transaction or of the contract make the acceptance dispensable, the contract is perfected without the formal acceptance by the addressee. This is the case of numerous contracts performed every day by any regular citizen. For example, when you take a bus, you are technically entering into a contractual relationship with the transportation provider. Imagine how inconvenient it would be if every person that gets on the bus had to formally express their acceptance to the proposal (contract of transportation). To avoid such a hassle, Article 225 allows contracts to be perfected regardless of these formal acceptances. When you take a bus, we can derive from customs and usage that you want to contract that service of transportation. Several everyday transactions occur under the umbrella of Article 225, making it easier for people to perfect contracts without the need of a formal acceptance.

## Article 226: Revocation of Acceptance or Rejection

### Article 226 Revocation of Acceptance or Rejection

1. If the addressee rejects the offer but subsequently accepts it, then acceptance shall prevail as long as it is received by the offerer, or comes to his or her knowledge, at the same time as the rejection or before it.
2. Acceptance may be revoked by way of a declaration that is received by the offerer, or comes to his or her knowledge, at the same time as the said acceptance or before it.

Just as proponents may wish to recant their proposals, addressees may wish to recant their acceptances or rejections. In cases where the addressee first rejects an offer but then decides to accept it, the acceptance is effective as long as it is received by the offerer, or is made known to him, at the same time as the rejection or before it. In other words, acceptance can preempt, or win out over, rejection if it arrives to the proponent before or at the same time as the rejection. On the other hand, when the addressee first accepts an offer but then decides to reject it, the acceptance may be revoked by a declaration recanting the acceptance if the recantation is received by the proponent, or is made known to him, at the same time as the acceptance or before it. The idea behind both of these provisions is that it is okay to change your mind about accepting or rejecting an offer as long as it doesn't potentially cause problems to the offerer. Since it is potentially bad for the offerer to think that you rejected something only to later find out you accepted it, or the other way around, since they likely started to make plans based on what you said to them, Timorese law doesn't let you change your mind at a later time once the offerer has found out about your first acceptance or rejection.

### Relevant Civil Code Articles

Article 215: Efficacy of Business Declaration

Article 216: Public Announcement of Declaration

Article 217: Death, Incapacity or Incidental Unavailability

Article 218: Fault in the Formation of Contracts

Article 219: Duration of the Contractual Proposal

Article 220: Late Receipt

Article 221: Irrevocability of the Proposal

Article 222: Death or Disability of the Offerer or the Addressee

Article 223: Scope of the Understanding

Article 224: Acceptance with Modifications

Article 225: Dischargeable Declaration of Acceptance

Article 226: Revocation of Acceptance or Rejection

### Examples and Discussion Questions

#### Example 1

Adelia Cbelo is leaving Timor to study in Australia for a few years, so she is selling all of her large possessions that she cannot take with her. Among the items she needs to sell are a television, a sofa, and a car.

- The Television: Adelia knows that her friend Iku has been looking for a television, so Adelia stops by Iku's house to see if Iku would like to buy hers. Iku is not home, but her mother is. Since Adelia is in a hurry to sell all of her items and pack for Australia, she asks Iku's mother to give her a message, which she writes on a napkin. The message reads, "Iku – If you would like to buy my television, you can buy it for 15 US dollars. Please let me know immediately if you can buy it because I am leaving in two days for Australia. I need to know before I leave whether you can buy it." Iku's mother delivers the note to Iku when she arrives home a few hours later, but Iku does not look at it right away.
- The Sofa: To sell the sofa, Adelia put an advertisement out in the local newspaper. The advertisement said: "One sofa for sale for only 30 US dollars! Don't like the price? Make an offer and I'll accept the highest offer I receive. But be quick—you have only two days to respond!" Unfortunately, the advertisement was delayed a day and was printed in the newspaper only a day before she was to leave. Only one person responded to the advertisement before Adelia left for Australia, Nelson Simoes. Adelia sold the couch to Nelson for the 15 US dollars that he offered.

- The Car: Adelia had another friend who she thought would like to buy her car, Nandy Santos. Adelia went to Nandy's house to make her an offer and found Nandy working outside. Just as Adelia was approaching her friend, however, Nandy got a phone call and said that she had to leave. Adelia managed to give Nandy a note with the offer before she left though.

### Discussion Questions

1. If Adelia leaves for Australia before Iku responds to her about buying the television, does Adelia have to sell Iku the television?
2. Now imagine that Iku's mother has dropped the napkin with Adelia's offer into the dishwasher by accident. Iku calls Adelia and says, "I received your note, but I can't read it. My mother told me that it said something about your television though. I would like to buy it if the price is right." However, just before Iku called, Adelia was offered 20 US dollars for the television. She wants to seize this opportunity to tell Iku that the price is 25 US dollars. Can she legally change her offer in this way?
3. What happens if the day after Adelia leaves for Australia, within two days of the newspaper advertisement for the sofa being printed, a man named Juan offers Adelia 30 US dollars for the sofa. Does Adelia have an obligation to sell the sofa to him? Remember that she has already sold the sofa to Nelson.
4. Poor Nandy! When she was driving away in a hurry, after receiving an urgent phone call from her employer telling her to get to work immediately, she got in a car wreck and was killed. She left everything to her son, Maubere. In looking through Nandy's belongings, the day after Adelia left for Australia, Maubere found a note from Adelia that said, "Nandy – If you would like to buy my car, you can buy it for 300 US dollars. Call me!" Can Maubere accept Adelia's offer to perfect the contract?

### Answers

1. No, Adelia does not have to sell Iku the television because the phrase "I need to know before I leave whether you can buy it," serves as deadline set by the proponent, Adelia. According to Article 219 of the Timor-Leste Civil Code, deadlines established by proponents override deadlines set by law.
2. Yes, Adelia can change her offer. According to Article 215, Adelia's offer will produce no effect, because it was unreadable and Iku (the addressee) was not at fault for this. As the offer is no longer valid, Adelia has the possibility to change it, especially because Iku does not even have ways to prove the price under the previous offer.

3. Yes, Adelia technically has an obligation to sell the sofa to Juan. Since she has already sold the sofa, Adelia will probably have to pay damages to Juan for breach of contract. To avoid this liability, Adelia should have placed an advertisement in the same newspaper rescinding the offer pursuant to Article 221 (3).

4. No, Maubere cannot accept the offer. While Article 219 would have given Nandy five days to accept Adelia's offer, only Nandy could have made the acceptance. Article 222 says that "[t]he offer shall be deemed ineffective following the death or disability of the addressee."

## 5. Interpretation and Incorporation

### *Overview of Interpretation and Incorporation in Contract Formation*

#### **SECTION OBJECTIVES**

- To understand how courts interpret declarations of willingness.
- To discover how absent provisions are incorporated into, or put inside, contracts ex post, or after the formation of the contract.
- To explore the effects of contract interpretation and incorporation in a few common scenarios.
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#### *How do courts interpret declarations of willingness? What is incorporation?*

In order to make contract enforcement predictable, the Timor-Leste Civil Code sets out rules for how courts should interpret declarations of willingness. These rules can be found in Civil Code Articles 227-229. For most declarations of willingness, courts will interpret the declaration to adopt the meaning that a "standard addressee, placed in the position of the actual addressee," would have of the declaration, pursuant to Article 227. This means that they will try to understand the offer as a normal addressee would understand the offer, and will interpret any confusing or unclear parts the way that the normal addressee would. This is an objective standard, meaning that the court isn't concerned with how the addressee actually interpreted the offer, but is concerned with how a normal addressee would likely understand the offer. This is so that the proponent isn't put in a bad legal situation if the addressee misunderstood the contract in a way that is very strange and that a normal addressee wouldn't misunderstand it. In some cases, though, special circumstances will require courts to use a different way of interpreting a declaration. These special circumstances are discussed in this section.



Incorporation is similar to contract interpretation, because it provides courts with rules for determining the meaning of a contract. Specifically, incorporation helps courts determine the meaning of missing provisions in contracts. As is explained later in this section, missing contract provisions are typically held to have the meaning parties would have assigned to them had the parties anticipated the need for the provisions in forming the contract.

*What are the rules for interpretation and incorporation in contract law?*

Interpretation

Article 227  
Standard Meaning of the Declaration

1. A declaration of intent shall have the meaning that any standard addressee, placed in the position of an actual addressee, may deduce from the behaviour of the declarant, unless he or she cannot reasonably rely upon such behaviour.
2. Whenever the addressee knows the actual will of the declarant, the declaration made shall be interpreted in the light of such will.

Article 227 provides the general rule for determining the meaning of declarations of willingness. It says that declarations have the meaning that “any standard addressee” in the same situation as the actual addressee would assign to the declaration as a result of observing the behaviour of the declarant. For example, imagine that a person offers to sell coffee beans to a friend, who owns a coffee shop in Dili. The offer said, “At the cost of the coffee beans plus 3%, the seller shall provide the buyer with enough coffee beans to meet his needs, with deliveries to be made at the beginning of each month and to continue for the next six months.” The friend with the café accepts this six-month supply contract and the contract is properly formed. However, after the first delivery, he is charged far more than he expected for the coffee. The seller says that he only charged the amount that they agreed to; the cost plus 3%. If the friend brings a law suit, how should the term “cost plus 3%” be interpreted and understood by the court? The court should give the contract the meaning a standard addressee would give the provision. In this case, the way the court will probably decide that a standard addressee would understand that the cost would be all of the costs that go into producing the coffee, plus 3% of

the cost of production. But what if the buyer had accepted the offer based on a different interpretation? For example, what is the buyer thought that the “cost of production” did not include the amount of money the producer had to pay laborers to harvest the beans? What if they thought the term “cost of production” only meant the cost of renting the land, the cost of fertilizer, and the cost of the containers used to hold the beans, and thought that the “plus 3%” on top of these costs was what was going to be used to pay the workers? According to Article 227, the addressee’s actual perception of the declaration is not relevant. The meaning that an ordinary addressee would assign to the declaration is the proper interpretation. Since the normal addressee would probably recognize that part of the “cost of production” when producing coffee beans was the cost of paying employees, and that the “plus 3%” on the contract was supposed to be profit to the owner, it is this interpretation that the court will use, and the buyer will be expected to fulfill their end of the agreement based on this. Nevertheless, a lawyer representing the buyer in the situation just described would also want to make arguments under the doctrine of unwillingness and will-related faults. Under these different doctrines it still might be possible for the client to get out of the contract, or at least to not have to pay as much money in damages for breaching it.

Article 227 contains two exceptions to the general rule. The first exception applies in situations where the addressee has reason to know that she cannot reasonably rely on the behavior of the declarant as evidence of the meaning of the declaration. The other exception is where the addressee knows the actual will of the declarant. If either of these exceptions applies, courts will factor these exceptions into their interpretation of a declaration. For instance, if the seller of the coffee beans had actually intended “cost plus 3%” to mean the cost of production, not including the cost of paying laborers, plus 3%, as profit to pay the laborers, and if the addressee knew this, than a court could interpret the contract in light of the shared will of the parties.

In some cases though, there will be too much doubt as to the meaning of declaration to assign any particular meaning to it. For those cases there is Article 228:

Article 228  
Cases of Doubt

In case of doubt the declaration shall have the meaning that is the less grievous for the grantor, in non-valuable transactions, or that which ensures a better balance of the considerations, in valuable transactions.

To understand how this could happen imagine that the offer to supply coffee for six months had said, “At the normal price, the seller shall provide the buyer with enough coffee beans to meet his needs.” What is a “normal price”? Is it market price, the price at which the seller normally supplies his coffee beans to the buyer, or some other “normal” price? Article 228 explains that the rules for interpreting declarations where there is irresolvable doubt as to the meaning of a declaration. In applying Article 228, the first step is determining whether the contract is valuable or non-valuable. For contracts that have economic value, courts will interpret declarations with the goal of balancing the considerations of the parties to the contract and being as fair as possible. For non-valuable contracts, courts try to give declarations interpretations that do not aggrive, or cause problems for, the declarant.

Formal contracts are interpreted slightly differently than other contracts. Look at Article 229:

Article 229  
Formal Transactions

1. In formal transactions the declaration shall not be valid if its meaning does not minimally correspond to the text of the respective document, albeit imperfectly expressed.
2. Such meaning may none the less be valid if it corresponds to the real will of the parties and the reasons determining the form of the transaction do not diminish such validity.

Pursuant to Article 229, the interpretation assigned to a declaration in a formal contract must at least minimally correspond to the text of the document, meaning that the agreement in writing must at least look similar to the actual agreement, or else the declaration shall be invalid. If the two do not look like the same agreement at all, both versions of the agreement are void. This law exists because the form of formal transactions, which are often mandated by law, is supposed to tell other people who are not involved in the contract that a particular agreement has

been made. Formal contracts cannot show other people what the point of the contract is if only the parties know the meaning of the text. In other words, the written contract cannot trick other people into not understanding what the actual agreement is.

There is an exception to this rule though in Article 229(2). This clarifies that if the form of a formal contract is not actually required by law, then the declaration may be valid even if its meaning is not the one an ordinary addressee would understand based on reading the document. Even if the form is legally mandated, this exception can still apply if “the reasons determining the form of the transaction,” which means the reasons the form is required, are not undermined, worked against, frustrated, or hindered by the special meaning assigned by the parties. This means that if the point of the law is to allow other people not involved in the contract to understand it, then this sort of contract is probably void. However, if the law doesn’t care whether or not other people can understand the contract, and has a different reason for requiring the agreement to be written down, it can still valid. In both of these cases though, the declaration may only be valid if corresponds to the real will of the parties.

### Incorporation

Article 230  
Incorporation

In the absence of special arrangements, the declaration of intent should be incorporated in accordance with the will that the parties would have had if they had anticipated the absent provision, or in accordance with bona fide rules, when such rules impose a different solution.

In addition to the rules for contract interpretation, the Timor-Leste Civil Code contains rules for “interpreting” missing contract provisions. In this context “interpreting” means inferring provisions that the judges think the parties would have included in the contract if they had thought about them. The interpretation of missing provisions is called incorporation because it requires courts to bring in, or incorporate, additional provisions into the contracts.

Sometimes, parties will put into their contract special rules for how they want the court to incorporate any missing provisions; this is just in case they forgot anything. Such special rules could say, for example, that if the court finds any necessary provisions missing, then the contract

should be deemed void. Alternatively, parties could include a provision in their contract requesting that the court incorporate any missing terms in such a way as to benefit one of the parties instead of the other or make explicit reference to a specific Code they wish to apply in case the contract is silent. Article 230 explains that, absent such special arrangements, missing provisions should be incorporated “in accordance with the will that the parties would have had if they had anticipated the absent provision” when they were forming the contract. For example, if the contract clearly favours one of the parties, but not so much that it shows an unfair bargaining process, then the court may incorporate missing provisions to also advantage the favoured party. However, if incorporating a provision in such a way would violate “bona fide,” or good faith, rules, then a court will interpret the missing provision differently, in accord with bona fide rules. To continue with the example just used, if incorporating the absent provision to the advantage of the already favoured party would be so unfair to the other party that it broke the rules of good faith, then the court might try to obtain better balance in incorporating the provision in a way that benefitted both parties more equally.

#### *Relevant Civil Code Articles*

Article 227: Standard Meaning of the Declaration

Article 228: Cases of Doubt

Article 229: Formal Transactions

Article 230: Incorporation

#### *Examples and Discussion Questions*

##### Example 1

Ameu Siempre is in negotiations with Nadya Viegas for the purchase of land. Ameu is the buyer and Nadya is the seller. In real life the rules for selling land are complicated, so for the purposes of this example, pretend that there are only two requirements for land contracts in Timor-Leste: (1) the land purchase contract must be in writing and a copy of the writing must be given to the government, and (2) it must state the price. In negotiating for the contract, Ameu and Nadya have encountered a difficult issue that they have requested your help with, as their lawyer. The issue is that Nadya is friends with Ameu, so she wants to give him a low price on the land. However, Ameu knows that the next buyer of the land will look at what Ameu paid for it, and

think that that is the correct value of the land. That will mean that if Ameu wants to sell it later, the future buyer will only want to give him the same low price. So while Ameu wants to pay a low price, he does not want the contract to show that he has paid a low price. Nadya asks you, “Can I write in the contract that the price of the land is 4,000 US dollars but have Ameu only pay me 3,750 US dollars? Since Ameu and I both know the meaning we have in mind, courts will interpret the contract in the way that we meant it and not the way that it was written, isn’t that correct?”

### Discussion Question

1. What is your answer to her question and how would you explain your answer?
2. How should a court interpret a provision in a contract for the sale of 200 kilograms of rice that says, “The buyer shall pay the seller the normal price for 200 kilograms of rice”? Imagine that between the time when the contract was finalized and the time when the payment became due, a drought happened and because of the shortage of rice the price of rice increased 25%.

### Answers

1. You should tell Ameu and Nadya that they cannot write a price in the contract that is different than the price they intend for Ameu to pay. There are many legal problems with them doing that. It probably even constitutes fraud which is a crime. If we just look at the issue of contract interpretation, however, we see that the land contract has a legally mandated form, and thus is a formal contract. This means that the interpretation of the contract will be governed by Article 229. Under Article 229(1), the contract would be invalid because the text would not “minimally correspond” to the meaning of the price provision. Moreover, an exception would not be available under Article 229(2) because one of the purposes of the mandated form of land contracts is to help future buyers learn about the value of the land. Because the purpose of the law would be undermined if we allowed the parties to define the price provision differently than a standard addressee would, the exception doesn’t work.
2. There is doubt that cannot be made clear about the meaning of this contract provision. Therefore, this issue is governed by Article 228. The first step is to determine whether the contract is valuable or not. A sales contract is valuable. Because it is considered a valuable contract, we can’t just decide in favor of the grantor, but instead the “missing provision” should be given the interpretation “which ensures a better balance of the considerations.” Since a drought has just caused the market price to rise significantly, a court would probably not interpret the provision as requiring market price to be paid, since that would be overly grievous, or harmful, to the buyer. The court would also probably avoid requiring the seller to accept the price the buyer normally pays him, since that would be overly grievous to the seller, given that

market conditions have changed so significantly to the seller's advantage and given that the seller probably has less rice to sell because of the drought. This question does not have a clear answer as to the actual exact interpretation that should be applied, other than that Article 228 requires courts to "balance equities," which means to consider what is fair to both parties, in the case of valuable contracts.

## 6. Unwillingness and Will-Related Faults

### *Overview of Unwillingness and Will-Related Faults in Contract Formation*

#### SECTION OBJECTIVES

- To understand that unwillingness and will-related faults are essential to understanding the legal requirement of voluntary consent.
- To explore the various types of unwillingness and will-related faults.
- To understand when contracts are voidable on the basis of unwillingness or a will-related fault.

#### *What does unwillingness mean? What is a will-related fault?*

In order to form a contract, all parties to the contract must voluntarily consent, or agree, to be bound by the contract's terms. "Unwillingness" is the legal term used to describe when someone doesn't actually really give permission or mentally consent to be bound by a particular contract. For example, if a person signs a written contract indicating his consent to be bound by that contract, that person may really have been "unwilling" to enter into the contract if he was physically forced to sign his name to the page. That is because being physically forced to do something isn't the same as agreeing or consenting to do it. Similarly, "will-related faults" occur when contracting parties try to provide consent but for some reason accidentally fail to do so. If a person were to say, "I'll sell you my car for 100 US dollars," but he actually meant to say "I'll sell you my car for 1,000 US dollars," the resulting contract might be void because of the existence of a will-related fault. This is because he didn't actually consent to sell his car for \$100, he meant to agree to only sell it for \$1000.

What are the different types of unwillingness and will-related faults?

Simulation

Imagine a situation where two people stand to gain something by convincing another person that they have entered into a contract. This is called “simulation,” because the contracting parties in such cases are simulating, or faking, their own consent. Since a simulated contract has the potential to disadvantage other people not involved in the contract who might believe it and rely on it, the law of Timor-Leste regulates simulated contracts in Articles 231-234 of the Civil Code. People who are not involved directly in a contract, but might be effected by the agreement, are called “third parties.”

Read the relevant articles in the box below and try to understand the regulatory structure for simulated contracts:

Article 231  
Simulation

1. If, by agreement of the declarant and the addressee, aimed at deceiving third parties, there is a discrepancy between the declaration of intent and the actual will of the declarant, the transaction is called simulated.
2. Simulated transactions shall be deemed null.

Article 232  
Relative Simulation

1. When behind the simulated transaction there is another transaction that the parties wanted to carry out, the latter shall be governed by the regulations that would have applied had it been concluded without dissimulation, and its validity shall not be harmed by the nullity of the simulated transaction.
2. If, however, the dissimulated transaction has a formal nature, it can only be valid if the form required by law has been complied with.

Article 233-1  
Legitimacy to Allege Simulation

1. Notwithstanding the provisions of Article 277, the nullity of the simulated transaction may be alleged by the simulators between themselves, even if the simulation is fraudulent.

Article 234  
Effects of Simulation Towards Bona Fide Third Parties



1. Nullity resulting from simulation may not be alleged by the simulator against a bona fide third party.
2. Bona fide means that simulation was ignored at the time when the respective rights were constituted.
3. Third parties having acquired the right after the simulation proceedings have been registered, whenever such registration is made, shall always be deemed to have acted in bad faith.

Now, let's go through the relevant articles one by one to understand their significance.

### *Article 231: Simulation*

Article 231 defines a simulated transaction as a transaction where “by agreement of the declarant and the addressee, aimed at deceiving third parties, there is a discrepancy between the declaration of intent and the actual will of the declarant.” Think about Adriana selling a house to Maria just so Adriana's creditors won't be able to claim the house as payment of her debts. There was not intent between Adriana and Maria to celebrate such a contract; it was only done to harm her creditors' rights. Therefore, there are three requirements for transaction to be considered simulated:

- **Agreement:** The contracting parties must have agreed before transacting that at least one person would make a declaration of intent without willing, or intending, that the declaration actually bind him.
- **Aim of Deception:** The aim of the agreement is to create a discrepancy between the declaration of intent and the actual will of the declarant so that they can deceive third parties. This rule limits Article 231 to regulating only situations where third parties might be at risk of being tricked. Keep in mind that the government might be considered a third party too. So, if two parties simulate a contract to avoid taxes, for example, when they were willing to make another contract, the simulated contracted is void.
- **Discrepancy Between Declaration and Actual Will:** Finally, there must be an actual discrepancy between the declaration of intent and the will of the declarant.

The second part of Article 231 says that “simulated transactions shall be deemed null.” This means that if the three requirements for a simulated transaction are met then the simulated transaction may be cancelled, or nullified.

#### *Article 232: Relative Simulation*

A special type of simulated transaction occurs when, as well as the fake simulated transaction, there is different secret transaction that the parties actually wanted to carry out. This is called a relative simulation. Article 232 says that in cases of relative simulation, the transaction that the parties actually wanted to carry out is governed by the regulations that would have applied had it been “concluded without dissimulation,” meaning, if it had been an honest, open, and normal transaction. Also, Article 232 says that the secret real transaction’s validity “shall not be harmed by the nullity of the simulated transaction.” This means that the desired transaction can remain binding even if the simulated transaction is cancelled. This is because it is a separate, unique, contract that is not based on the one that is null. Lastly, Article 232 says that transactions with specific requirements of form “can only be valid if the form required by law has been complied with.” In other words, all of the rules of regular agreements being valid, including form requirements, are still required for the secret agreement to be valid.

#### *Article 233(1): Legitimacy to Allege Simulation*

Article 233(1) says who can “allege simulation.” In other words, this article specifies who can start the process of nullifying a transaction by claiming that one or more of the parties to the transaction simulated their will. Article 233(1) says that the simulators themselves may allege nullity of the simulated transaction, “even if the simulation is fraudulent.” In other words, a party making the fake transaction can tell the court that it was supposed to be fake and complain if the other party starts acting as though it was supposed to be a real transaction.

Article 233 (2) extends the legitimacy to allege simulation to legitimate heirs of a person who may have used simulated transactions to prevent them from receiving what they should receive. In other words, if the simulated transaction will have effects in their inheritance, they can allege and challenge the simulated transaction.

#### *Article 234: Effects of Simulation Towards Bona Fide Third Parties*

Article 234 explains the effects of simulation towards bona fide third parties. Article 234(2) defines “bona fide” to mean a third party that was unaware that the transaction was simulated when the fake contract came into effect. That means that bona fide third parties are innocent people who don’t know that anyone else is lying about the contract. Article 234(1) states that “nullity resulting from simulation may not be alleged by the simulator against a bona fide third party.” This means that a person engaging in a fake transaction to deceive a bona fide third party, who is innocent, cannot subsequently claim that the transaction is null.

Since a “bona fide third party” is one who is completely unaware of the simulation, once the proceedings for declaring nullity of a simulated transaction have started, we cannot say that third parties are unaware of the possibility of simulation. After the motion for determining the nullity of a transaction based on its simulation has been filed before a court (registered), third parties are not considered “bona fide” anymore.

### Mental Reservation

Article 235  
Mental Reservation

1. Mental reservation exists whenever a declaration is issued contrary to the actual will, with the intent to deceive the addressee.
2. Reservation shall not harm the validity of the declaration, if the addressee is aware of its existence. Otherwise the reservation has the effect of simulation.

Mental reservation is similar to simulation in that it involves a transacting party making a declaration contrary to his or her actual will. This means that the party is lying about his or her real intention behind the transaction. However, while simulation deals with transacting parties seeking to deceive third parties; mental reservation involves one party to a transaction seeking to deceive the other party.

Pursuant to Article 235, there are two requirements for a mental reservation:

- Declaration Contrary to Will: There must be a declaration made contrary to actual will. This means that a declarant must make a declaration while in their mind being unwilling to be bound by it.

- Intent to Deceive the Addressee: Additionally, the declaration must have been made with the intent of deceiving the addressee, the declarant's counterpart in the transaction.

Article 235 also lays out the rules for what happens when a declarant makes a mental reservation. The result depends on whether the addressee is aware of the mental reservation, since he is the one at risk of being harmed by it. If the addressee is unaware of the existence of the mental reservation, the validity of the declaration is not affected by the mental reservation in a clear attempt to protect the other party that was being deceived. If, however, the addressee is aware of the reservation, the rules for simulation apply; and according to Article 231, "simulated transactions shall be deemed null."

### Untrustworthy Declaration

If we think about it, we make declarations of intent all the time. Sometimes, however, we do not really mean to make them. The context and the circumstances under which we make some declarations make it clear that we do not want to be bound by them. Think about things you say when you are joking or when you are very excited, for example. These are considered untrustworthy declarations.

Read the text of Article 236 in the box below and see if you can figure out what happens when an untrustworthy declaration is made:

Article 236  
Untrustworthy Declarations

1. An untrustworthy declaration, in the hope that its lack of trustworthiness is not unknown, shall produce no effects.
2. If however the declaration is made in such circumstances that the addressee is justifiably led to accept its trustworthiness, then he shall be entitled compensation for any loss that he suffers.

There are two types of untrustworthy declarations: ones where the declaration was made in hopes that the addressee knew of its untrustworthiness and ones where the addressee is reasonable in thinking that the declaration is trustworthy. The legal effect of an untrustworthy declaration depends on the type of untrustworthy declaration it is.

Article 236(1) says that declarations made with the hope that the addressee knows of its untrustworthiness “produce no effects.” This means that untrustworthy declarations cannot form valid business transactions. These are the cases where the other party knows or should know that the declarant is not serious or does not really mean what he is saying. If you are clearly joking about something, your declaration is not binding.

If, however, the addressee is justifiably and understandably led to believe the declaration is serious, then the addressee is entitled to compensation for any loss that he suffers because he trusted the declaration.

### Unawareness of the Declaration

Another type of unwillingness arises when a declarant is unaware that she has made a declaration of intent. Article 237 of the Civil Code regulates this form of unwillingness, and also physical coercion, but physical coercion will be addressed separately later in this chapter.

Read the text of Article 237 in the box below and try to figure out what happens when a declarant makes a declaration without realizing that they are doing so:

Article 237  
Unawareness of the Declaration of Intent and Physical Coercion

The declaration shall produce no effect if the declarant is unaware that he made a declaration of intent, or has been physically coerced to make it. If however unawareness in the declaration is due to fault, then the declarant shall have the duty to compensate the addressee.

Article 237 says that unless unawareness of a declaration is due to the fault of the declarant, the declaration “shall produce no effect.” In this case, “produce no effect” means that the declaration cannot form part of a valid transaction and the contract is void and invalid. It is void because the declarant lacked willingness to be bound by the declaration. However, if it is the declarant’s own fault that he was unaware of the declaration, then the addressee is entitled to compensation from the declarant for harms suffered as a result of the unawareness.

### Mistake

Mistake is an important and complicated will-related fault. The legal term “mistake” means something more specific than what we mean when we use the word “mistake” normally and it is important to not confuse the two definitions. At its most basic level, legal “mistake” occurs when a declarant makes a declaration believing something about the declaration that is actually false or wrong. When a declarant makes a declaration based on false information or an incorrect assumption, the result is a legal “mistake.” Since there are many different forms of mistake, and since each form has different effects, we’ll look at each form of mistake individually.

*Mistaken Declaration:*

Article 238  
Mistaken Declaration

When, by virtue of mistake, the declared will does not correspond to the author’s actual will, the declaration of intent is annulable, provided that the addressee knew, or should not ignore, that the mistaken part was essentially important for the declarant.

As explained above, a “mistaken declaration” occurs when a declarant makes a declaration that is not his actual will or desire and does so because he is mistaken. Think about a person who wants to buy some land to plant rice but does not know that the soil of the land is rocky and not fertile. Article 238 of the Timor-Leste Civil Code makes mistaken declarations annulable, or possible to void, as long as the addressee “knew, or should not ignore the importance of the mistaken part for the declarant.” In the example given, if the declarant had mentioned his intentions to plant rice on the land he was about to purchase to the addressee and the addressee ignored the fact that the soil is unfertile and therefore useless for the declarant, the declaration is annulable. If the declarant is only interested in the land for planting rice, the fertility of the soil is an element of essential importance to him. The address should have known that if the declarant knew the land was infertile, he would not have purchased it.

Article 238 lays out the basic standards for analyzing mistaken declarations. Other Civil Code Articles governing mistaken declarations reference to Article 238 for the terms upon which mistaken declarations may be annulable.

*Mistaken Calculation or Drafting:*

Article 240  
Mistaken Calculation or Drafting

Mere calculation or drafting mistakes evidenced in the context of the declaration, or the circumstances in which the declaration is made, allow only for the correction of such declaration.

Article 240 states that when a mistaken declaration is the result of a calculation or drafting mistake, the mistakes may be corrected, but the declaration of intent itself is not annulable. For example, if a buyer and seller create a sales contract for the sale of a car for 1,000 US dollars, but write in the contract, by mistake, that the sale price is 100 US dollars, then the seller will be permitted to correct the contract to require 1,000 US dollars from the buyer. However, the seller cannot choose to annul or cancel the contract and keep the car, because Article 240 does not allow for annulment of contracts on the basis of drafting mistakes.

*Mistaken Conveyance of the Declaration:*

Article 241  
Mistaken Conveyance of the Declaration

1. If the declaration of intent is inaccurately conveyed by the person in charge of its conveyance, it can be annulled as laid down in Article 238.
2. When however such inaccuracy results from criminal intent of the intermediary, the declaration is annulable at all times.

Often times, people do not make declarations of intents themselves. This is the case when a party confers powers to relatives or attorneys to act on their behalf (legal representative). When the representative of the declarant inaccurately conveys the declaration of intent, this is called a “mistaken conveyance of the declaration.” For an example of how this could happen imagine a declarant writes out two declarations of intent, a rough draft and then later a final draft in which he changed a lot of the terms and provisions and prices and gives both to his representative, giving him instructions to use the latter. Imagine then that the representative gets confused and

uses the rough version to base his declaration. Article 241(1) explains that the effect of a mistaken declaration is to make the declaration annulable if it qualifies under Article 238, in the sense that the difference between the declaration that was conveyed and the real will of the declarant is “essential”. The declarant would not have wanted to close the deal in the terms mistakenly conveyed.

To understand Article 241(2), it is important to realize that declarations of intent may be conveyed by individuals other than the declarant, such as an agent of the declarant, as discussed earlier. When someone other than the declarant is “in charge” of conveying a declaration and willingly conveys an inaccurate version of the declaration, such as to commit fraud, Article 241(2) makes the declaration annulable. Here, the term “criminal intent” should be understood to mean an intentional or purposeful bad faith. It does not necessarily have to raise to criminal law standards, but can be any sort of willful misconduct or bad acts before it is enough to render the contract annulable. The exception are for the small deceits or little tricks that are common in business transactions in a community and not considered serious.

*Mistake Regarding the Person or Object of the Transaction:*

Article 242

Mistake Regarding the Person or the Object of the Transaction

If the mistake affects the rationale behind the will, regarding the person of the addressee or the object of the transaction, such transaction becomes annulable as laid down in Article 238.

When a declarant makes a mistake about the person he is transacting with or the object of the transaction, the mistake might affect the declarant’s will to enter into the contract. In such cases, Article 242 makes the transaction annulable under Article 238. To better understand this, imagine that a taxi driver entered into a contract with his friend to buy a car for his taxi service. His friend owns a car dealership. The taxi driver points at a car far away and say “I want to buy that one”. His friend believes he is referring to a different car and concludes the transaction based on that different vehicle. This is an example of a mistake regarding the object of the



transaction. The buyer wanted to buy one car but is actually buying a different one. This transaction is therefore annulable.

*Mistake Regarding the Rationale:*

Article 243  
Mistake Regarding the Rationale

1. Mistakes affecting the rationale behind the will, but not the person of the addressee or the object of the transaction, can only be the cause for annulment if the parties have agreed on the essentiality of the motif in writing.
2. If however such mistake affects the circumstances that constitute the basis of the transaction, the provision governing the dissolution or modification of the contract due to change in the conditions in force at the time of contract conclusion shall apply.

When the mistake is of particular importance for the decision of making the transaction and does not relate to the person or the object of the transaction, then we have a mistake regarding the rationale. Think about a person willing to buy a horse for racing but who is actually buying a pack-horse. In this case, we cannot say there is a mistake with regard to the object of the transaction because there is only one horse involved. The problem is that the declarant is not fully aware of the type of horse he is buying. In this case, unless declarant puts in writing that the quality of being a racehorse is essential to the transaction, the transaction is not annulable. This is a system to somehow protect the addressees who cannot know about all the particular reasons that people might have for entering into some legal transactions. The addressee does not need to ask what is the horse for. In other words, for a mistake regarding rationale to make a transaction annulable, it is required that such a rationale is expressed in writing as an essential part of the transaction otherwise the addressee could not know about it. In other cases, the mistake might derive from a change in the circumstances under which the contract was formed. In the example of the purchase of a racehorse, think about a situation where the horse will be paid in installments and meanwhile a law is enacted imposing extra taxes on the purchases of animals. Now, the circumstances under which the contract was formed have changed and the declarant might not be willing to keep the contract since the financial burden for him will be a lot higher than he expected. Article 243 (2) deals with this situations stating that whenever there is a

change in the circumstances under which the contract was formed, the rules regarding dissolution may apply. **That means that the provisions of Article 372 apply in such cases.**

### Validation of the Transaction

Article 239  
Validation of the Transaction

Possibility of cancellation due to mistake shall not apply if the addressee accepts the transaction according to the declarant's will.

Article 239 provides an important exception to all other Civil Code Articles that make transactions annulable due to mistake. Article 239 states that transactions shall not be annulable due to mistake "if the addressee accepts the transaction according to the declarant's will." This means that if the addressee validates the declarant's actual will by accepting it after the mistake has been discovered and corrected, than neither party can have the transaction annulled. This rule is important to know because sometimes a declarant may want out of the contract entirely, for example because of a change in circumstances or prices, but this is not possible if the addressee wants to stay in the contract even after it has been modified to fit the declarant's original will; the will he had at the time it was formed.

### Criminal Intent

Article 244  
Criminal Intent

1. Criminal intent means any suggestion or ruse employed by somebody with the intent or notion of inducing error or maintaining in error the author of the declaration, as well as the dissimulation, by the addressee or a third party, of the declarant's error.
2. The commonly employed suggestions or ruses, considered legitimate in the current conception of transactions, shall not be deemed to constitute criminal intent. Nor will error dissimulation, when the law, legal stipulations or the conception of transactions impose no duty to provide clarification to the declarant.

In the context of contract formation, “criminal intent” refers to sneaky, conniving, bad spirited actions undertaken to cause declarants to make declarations of intent that do not correspond with their actual will; mistaken declarations. Another way of thinking about “criminal intent” is as a form of bad faith where the party is trying to trick the other party. Criminal intent also encompasses actions undertaken to maintain or hide an error in a declarant’s declaration of intent. However, Article 244 does not deem “commonly employed suggestions or ruses, considered legitimate in the current conception of transactions” to be criminal intent. That means that small tricks in order to get a better deal are not bad enough to rise to the level of criminal intent, such as not pointing out that it is standard practice in the type of contract being made for the declarant to charge interest on a loan, but that the declarant was not doing so. Error dissimulation, which means obscuring or hiding an error made by a declarant, is also permissible when there is no duty imposed by law or otherwise to provide clarification to the declarant.

Article 245 describes the effects of criminal intent. Read through Article 245 carefully and try to figure out how criminal intent affects declarations of intent:

Article 245  
Effects of Criminal Intent

1. Any declarant whose will has been determined by criminal intent may annul the declaration. Annulability shall not be discarded just because the criminal intent is bilateral.
2. When criminal intent is originated by a third party, the declaration is annulable only if the addressee has (or should have) knowledge of it. If however any person has acquired any right by virtue of the declaration, the said declaration is annulable as regards the beneficiary – if he showed criminal intent, or knew it, or should have known it.

As you might have learned from reading the text of Article 245, criminal intent can have the effect of annulling declarations. For the declaration to be annulable, the declarant’s will must have been “determined” by the criminal intent, meaning that the conniving action undertaken must have altered the declarant’s will, causing him to make his declaration of intent. One good way to think about it is: would the declarant have made the same declaration even if the wilful misconduct hadn’t occurred? Article 245 also states, “annulability shall not be discarded just because the criminal intent is bilateral,” meaning that even if both parties engage in deception constituting “criminal intent”, the affected declarations will still be annulable.

Article 245(2) deals with situations where the criminal intent is originated by a third party. In such situations, declarations caused by criminal intent are only annulable if the addressee had, or should have had, knowledge of the deception. However, if a third party both originates the criminal intent and is a beneficiary of the declaration induced, or caused by the criminal intent, then the declaration is annulable as regards the third party. Think about a donation with charges. João donates his house to Maria with the charge that Maria allows Julio to live in the house. Julio has tricked João into believing he needs a place to live when in fact he already owns a house. In this case, Joao is unaware of the wilful misconduct and is as tricked as Maria. According to Article 245 (2), the transaction can only be annulled if the addressee knew or should have known about the wilful misconduct of the third party (Julio). Therefore, the donation would not be annulled. What can be annulled is the provision that benefits Julio (since he is acting in willful misconduct). The donation would be valid and the charge would be annulled.

If, on the other hand, both Julio and Joao had acted in wilful misconduct to trick Maria, the whole donation may be annulled.

### Physical and Moral Coercion

#### Article 237

#### Unawareness of the Declaration of Intent and Physical Coercion

The declaration shall produce no effect if the declarant is unaware that he made a declaration of intent, or has been physically coerced to make it. If however unawareness in the declaration is due to fault, then the declarant shall have the duty to compensate the addressee.

#### Article 246

#### Moral Coercion

1. Moral coercion exists when the declarant made a declaration of intent for fear of a wrong of which he was unlawfully threatened to secure his or her declaration.
2. The threat may target the person or the honour or the assets of the declarant, or of a third party.
3. Neither threat to normally exercise a right nor mere reverential awe shall be deemed as coercion.

Article 237 deals with two situations where the declarant has very little mental involvement in the decision to make the declaration. One situation occurs when a declarant is unaware that he has made a declaration of intent. The other situation is when a declarant is physically coerced or forced to make a declaration, for instance, by threat of violence. In both of these cases, the declaration of intent produces no effect, since the declarant lacked the will to make the declaration. The only exception to this is in the case where the declarant is unaware that he has made a declaration of intent and where the declarant's unawareness is his own fault; In this case, the declarant must compensate the addressee for any damages he might have had for believing in such a declaration.

Article 246 addresses moral coercion, which occurs when a declarant is induced to make a declaration of intent by an unlawful threat to the declarant's person, honour, or assets, or by a threat to a third party. When a declarant is morally coerced to make a declaration of intent, the declaration is annulable. However, threatening to do something that someone has the right to do unless the other person agrees to enter into a contract, is not considered moral coercion. Situations that inspire the declarant to reverentially awe someone or something also do not constitute moral coercion, even if they play a role in encouraging the declaration.

Read the text of Article 247 and try to determine when morally coerced declarations are annulable:

Article 247  
Effects of Coercion

A declaration of intent extorted by way of coercion is annulable, even if such coercion is exercised by a third party. In this case however the tort must be serious and the fear of its materialisation must be justified.

Article 247 explains that the effect of moral coercion is to annul affected declarations in most cases. Recall that Article 237 deemed physically coerced declarations to produce no effect, meaning that they do not require annulment, since they do not create any obligations in the first place. According to Article 247, morally coerced declarations are generally annulable. However, when the coercion is exercised by a third party, then the threat must be sufficiently serious and likely to materialize to justify a declarant being truly induced to make the declaration contrary to

his actual will. This exception reflects the law's preference for taking the rights of both contracting parties into account as much as possible. Since in this case the other party didn't do anything wrong, the court does not want to deprive him of his contractual benefits unless there is a really good reason to. Article 247 permits the annulment of declarations more easily when the addressee committed the coercion, because in such cases the rights of the addressee were wrongly acquired in the first place and so the court does not mind depriving him of the contract.

### Accidental Disability

Article 248  
Accidental Disability

1. Any declaration of intent made by somebody who was accidentally unable, due to any cause, to understand its meaning, or could not freely exercise his or her will, is annulable, provided that the fact is clear to the addressee, or known by him.
2. A fact is clear when any average person could have noticed it.

Article 248 deals with declarations of intent made by declarants who were accidentally unable to understand the meaning of their declaration or were otherwise unable to freely exercise their will. In such cases, if “the fact is clear to the addressee, or known by him,” that the declarant was acting without free exercise of his will, then the declaration is annulable. Article 248 defines a fact as clear when “any average person could have noticed it.” This can happen, for example, when someone cannot understand the language that the contract is made in very well, and the counterparty should be able to realize that this. In this case, if the declaration included terms the declarant did not understand, the contract will likely be annulable as the other party should have realised this was a problem and made sure he understood.

#### *What happens to transactions when there is unwillingness or a will-related fault?*

As previously explained, the effects of unwillingness and will-related faults on the validity of declarations depend upon the type of unwillingness or will-related fault, and often on additional factors. Here is a summary of what happens to transactions when there is unwillingness or a will-related fault, classified by form:

- **Simulation:** Simulated transactions are deemed null. In the case of relative simulation, however, the real, desired transaction's validity is not harmed by the nullity of the simulated transaction. While simulators themselves may allege nullity of the simulated transaction even if the simulation is fraudulent, a person who has engaged in a simulated transaction to deceive a bona fide third party cannot claim that the transaction is null against the third party.
- **Mental Reservation:** If the addressee is unaware of the existence of the mental reservation, then the reservation does not cause the declaration to be nullified. If, however, the addressee is aware of the reservation, the rules for simulation apply, creating the possibility of nullification.
- **Untrustworthy Declaration:** Declarations made with the hope that the addressee knows of its untrustworthiness produce no effects. If, however, the addressee is justifiably led to accept a declaration as trustworthy, then the addressee is entitled to compensation for any loss that he suffers as a result of accepting the declaration as worthy of trust.
- **Unawareness of the Declaration:** In cases of unawareness, the declaration of intent produces no effect, unless the declarant's unawareness is his own fault, in which case, the declarant must compensate the addressee as the court requires.
- **Mistake**
  - **Mistaken Declaration:** Mistaken declarations are annulable, as long as the addressee knew, or should not ignore, the importance of the mistaken part for the declarant.
  - **Mistaken Calculation of Drafting:** When mistaken declarations are the result of mere calculation or drafting mistakes, the mistakes may be corrected, but the declaration of intent itself is not annulable.
  - **Mistaken Conveyance of the Declaration:** When there is a mistake in the conveyance of a declaration due to the representation of the declarant, the declaration is annulable provided that mistake concerns an essential element of the transaction, meaning that the declarant would prefer not to close the deal in the mistaken terms. When someone other than the declarant is "in charge" of conveying a declaration and criminally conveys an inaccurate version of the declaration, the declaration is also annulable

- Mistake Regarding the Person or Object of the Transaction: Mistake about the person or object of the transaction make transactions annulable under Article 238 when they affect declarants’ will to enter into the contract.
- Mistake Regarding the Rationale: For a mistake affecting the rationale behind the will to be grounds for annulment under Article 243, the parties must have included a written statement in the contract that the rationale of one or both parties was essential to the contract.
- Validation of the Transaction: Transactions are not annulable due to mistake if the addressee validates the declarant’s actual will by accepting it after the mistake has been discovered.
- Criminal Intent: Criminal intent can have the effect of annulling declarations, if the declarant’s will was “determined” by the criminal intent. Annulability is not discarded just because the criminal intent is bilateral, meaning that both sides of the contract had bad intent. When the criminal intent is originated by a third party, declarations caused by criminal intent are only annulable if the addressee had, or should have had, knowledge of the deception. If a third party both originates the criminal intent and is a beneficiary of the declaration induced by the criminal intent, the declaration is annulable as regards the third party.
- Coercion
  - Physical Coercion: A physically coerced declaration of intent produces no effect.
  - Moral Coercion: Morally coerced declarations are generally annulable. However, when the coercion is exercised by a third party, then the threat must be sufficiently serious and likely to materialize to justify a declarant being truly induced to make the declaration contrary to his actual will.
- Accidental Disability: If the fact of the accidental disability is clear to the addressee, or known by him, then the declaration is annulable.

*Relevant Civil Code Articles*

Articles 231-234: Simulation

Article 235: Mental Reservation



Article 236: Untrustworthy Declaration

Article 237: Unawareness of the Declaration

Articles 238-243: Mistake

Articles 244-245: Criminal Intent

Articles 237 & 246-247: Coercion, Physical and Moral

Article 248: Accidental Disability

### Examples and Discussion Questions

#### Example 1

Maya Goncalves is planning to open a coffee shop, called Maya's Escape, and she has just concluded negotiations with two different suppliers to provide different products for her café. Because of this, Maya now has two contracts. Maya's first contract is with Manuel Gama to supply her with the coffee beans she needs. Her second contract is with Joel Viegas to supply her with the sugar she needs. For purposes of this hypothetical, assume that the Manual and Joel are not considered merchants, so the Commercial Code of Timor-Leste, which otherwise would apply in this case, does not apply. Here are the details of each negotiation and each resulting contract:

- **The Coffee Beans Contract:** When Maya was negotiating with Manuel, she explained that she expected to have 100 customers per week, buying a cup of coffee each, so she would need 5 kilograms of coffee beans per week. An expert in coffee beans, Manuel realized that Maya had made a mistake in calculating the amount of coffee beans she needed, since just 1 kilogram of coffee is enough to produce 120 cups. However, Manuel did not inform Maya of the mistake because he wanted to increase his sales. The important part of the contract between Maya and Manuel read as follows: "For the next 2 years, Manuel Gama will deliver 5 kilograms of whole Arabica coffee beans to the coffee café named Maya's Escape every Monday, beginning on December 10, 2012, in exchange for monthly payments from Maya Gonclaves of 90 US dollars, to be paid at the end of each month. In the event that Maya's Escape ceases operation prior to December 8, 2014, for any reason, Ms. Gonclaves and Mr. Gama will both be released from their respective obligations to buy and supply coffee beans in accordance with this contract."

- **The Sugar Contract:** The sugar supplier, Joel Viegas, was more sympathetic to Maya's situation as a new business owner. He helped Maya calculate the amount of sugar she would need based on her estimate of having 100 customers per week and even gave Maya a discounted price. The important part of the sugar supply contract read: "Joel Viegas will deliver 15 kilograms of sugar to Maya's Escape on the first of every month for the next three years, beginning next month, in exchange for 20 US dollars to be paid to Mr. Viegas in cash upon the delivery of the sugar." Maya was so happy with Joel's customer service that she forgot to include a condition, like the one in the other contract, that released her from her obligation to purchase sugar should her café close for any reason.

### Discussion Questions

1. Maya's Escape performs as she expected and she has 100 customers per week for the first two months. However, she soon realizes that her coffee beans are piling up and that she made a mistake in calculating her supply needs. Maya feels cheated by Manuel and files a case against him to have the contract changed. Do you think that Maya will be successful in having the contract changed? Could she have the contract annulled?
2. What happens to Maya's obligations in each of the following situations and why?:
  - (a) Maya's Escape has to cease operations because the business is not profitable.
  - (b) Maya's business is profitable, but she only has 50 customers per week.

### Answers

1. Clearly, Maya was mistaken about the quantity of coffee and Manuel knew so. Article 243 states that a mistake may cause annulment of the contract if the addressee knew the importance of the mistake to the transaction and such an importance is put in writing. That means that if Maya had written that this quantity was due to such a number of expected customers, Maya could argue the mistake and request annulment. However, by not putting such a reason in writing, a judge would probably rule in favor of Manuel.
2. The scenarios described would have the following effects on Maya's obligations:
  - (a) If Maya's Escape had to go out of business as a result of not being profitable enough, Maya's obligations from her coffee bean supply contract would be terminated as a result of the condition in the contract covering the possibility that this might happen. The sugar supply contract, however, would result in more complicated legal issues. Since Maya forgot to put a condition in the sugar supply contract providing for her to be free from the obligation to buy sugar if her business failed, she must rely on the doctrine of mistake to allow her to annul the contract.

Specifically, Maya could claim that her declaration of intent was affected by a mistake regarding the rationale, because her declaration was driven by the mistaken rationale that her business would be operating for at least the next three years. Maya could argue the change of circumstances under which the contract was formed pursuant to Article 243 (2). Later we are going to see that Article 372 could also be deemed applicable. . It is uncertain whether such an argument would be successful with the judge.

(b) If Maya's business is profitable but she has only 50 customers per week, instead of the 100 that she expected, then there would be a mistake in the rationale underlying the will behind Maya's supply contracts. Pursuant to Article 243, for Maya's obligations to be annulable or correctable as a result of such a mistake, the parties would have had to include a written statement in the contract that Maya's rationale was essential to the contract, which they did not do. Even though Maya explained to her suppliers that her rationale in creating the supply contracts was based on an estimated 100 customers weekly, Maya did not include this information in writing in the contract, so she will have to rely on her suppliers to accommodate her request to change the contracts.

### Example 2

Two grocery store owners, Filipe and Guido, were lifelong friends. They grew up in the same small village and they trusted each other like brothers. Since Filipe had a university education in business management, Guido frequently relied on Filipe for advice in managing his grocery store. One day, Filipe's father, Ino, informed Felipe that he had used all of his money to buy a large bakery that was about to go bankrupt. Ino was so angry and upset at his bad decision that he started hitting his son, Filipe, until Filipe agreed to sign a contract to have Ino's bakery supply Felipe's grocery store with a year's worth of bread for 1000 US dollars, with full payment due before any deliveries. Ino also demanded that Filipe convince Guido to sign an identical contract. Fearing that his father would hit him even harder if he refused, Filipe convinced Guido to sign the same type of contract. Guido signed the contract without thinking about it because he trusted Filipe's advice completely. Both Ino and Filipe knew before the contracts were signed that the bakery would go bankrupt before the end of the year and that the two grocery stores would not receive all of their bread. Filipe then abandoned his shop and moved to Indonesia to escape his abusive father. Guido paid the bakery 1,000 US dollars and immediately afterward the bakery stopped operating without ever delivering any bread to either of the stores.

### **Discussion Questions**

1. Does Filipe have an obligation to pay Ino 1,000 US dollars?

2. Can Guido legally recover his 1,000 US dollars? If so, how?

### Answers

1. Filipe does not have an obligation to pay Ino 1,000 US dollars, because he was physically coerced into signing the bread supply contract. Article 237 explains that in cases of physical coercion, the declaration of intent produces no effect, since the declarant lacked the will to make the declaration.

2. Guido can recover his 1,000 US dollars from Ino, because Ino's declaration of intent may be annulled. When Filipe convinced Guido to sign the contract – regardless of the threat he was suffering from his father – he knew he was deceiving Guido. So, Article 244 and 245 apply as Filipe acted with willful misconduct.

## 7. Representation

### *Overview of Representation in Contract Formation*

#### SECTION OBJECTIVES

- To understand that parties can enter into contracts through representatives authorized to act on their behalf.
- To explore the effects of representation on contract formation.

#### *What does “representation” mean in the context of contract formation?*

Parties who want to form a contract can arrange for representatives to act on their behalf, or for them. A common arrangement is for lawyers to act as representatives; but other people, even friends and family members, can act as representatives as well. When a party arranges for someone else to enter into a contract for them, they are said to have “representation.” In such situations, the party who wants to enter into the contract is the “principal” and the person acting on their behalf is the “agent.” The relationship between these two people is called “the principal-agent relationship.” Civil Code Articles 249-260 regulate the principal-agent relationship.

#### *How does a person enter into a contract through a representative? How is contract formation affected by a party's use of representation?*

#### Article 249

### Effects of Representation

A legal transaction performed by the agent on behalf of his or her principal, within the powers granted to him, produces its effects in the legal sphere of the latter.

#### Article 250

##### Unwillingness or Will-Related Faults and Relevant Subjective States

1. Except for those elements in which the will of the principal has been decisive, unwillingness or will-related fault must be found in the person of the agent, as well as knowledge or ignorance of the facts that may impact on the effects of the transaction.
2. A principal acting in bad faith shall not benefit from a bona fide agent.

#### Article 251

##### Justification of the Powers of the Agent

1. If a person, on behalf of another person, addresses a declaration to a third party, the latter may require that the agent make proof of his or her powers within a reasonable deadline, or the declaration will produce no effects otherwise.
2. If the powers of representation are laid down in a document, the third party may request a copy of such document signed by the agent.

#### Article 252

##### Transaction with Oneself

1. Any transaction performed by the agent with himself or herself, either in his or her own name or in representation of a third party, is annulable unless the principal has specifically agreed with it or the transaction excludes the possibility of conflict of interest due to its nature.
2. For the purpose of the foregoing paragraph, a transaction performed by the person who has been appointed a substitute agent is deemed to have performed by the agent himself or herself.

The result of creating a principal-agent relationship is that, unless something unusual happens, the agent is the one that makes the contract but the principal is the one that is bound by it. Civil Code Article 249 describes this idea by saying “[a] legal transaction performed by the agent on behalf of his or her principal, within the powers granted to him, produces its effects in the legal sphere of the latter.” For example, imagine that a young man has put an advertisement in the newspaper offering to sell his car for 2,000 US dollars. When the young man discovers that he needs to leave the country immediately to visit a sick relative, he asks his friend to read the responses to the advertisement for him and authorizes, or allows, his friend to sell the car for

him for any price over 1,500 US dollars. If the friend is able to sell the car, the young man will be bound by the contract the friend makes with the buyer as long as the friend acted within the scope of authority he was granted, meaning that he is bound as long as his friend only did what he told his friend he could do.

When a party makes a contract through an agent, she explicitly, or clearly and exactly, says what her will is with respect to some parts of the contract and leaves other parts of the contract for the agent to decide about. The more elements the principal leaves to the agent to sort out, the more flexibility, or ability to choose different options, the agent will have in negotiating a contract. While the decision about how much flexibility the agent should have is often determined by the type of contract to be negotiated, and the context, this decision also affects whose will is examined for unwillingness or will-related fault. Article 250 explains, “unwillingness or will-related fault must be found in the person of the agent, as well as knowledge or ignorance of the facts that may impact on the effects of the transaction,” unless “the will of the principal has been decisive” on a specific part of the contract. This means that fault can only be found in the will of the principal if she has explicitly stated her will to the agent. Otherwise, only the agent’s will matters for the purpose of finding unwillingness or will-related fault.

Article 250 also states that “[a] principal acting in bad faith shall not benefit from a bona fide agent.” This law exists to prevent principals from arranging for an agent to make their contracts for the specific purpose of avoiding bona fide rules.

Another rule of representation within the context of contract formation is that addressees of declarations made by agents have the rights, under Article 251, to request proof of the agent’s powers to represent the principle and/or a copy of any document that grants the agent these powers. If such proof or documentation is not provided by the agent within a “reasonable deadline” then the declaration produces no effect.

The final rule of representation covered in this text protects principals against agents acting in their own self-interest, instead of acting only in the interest of the principal. Article 252 states that “[a]ny transaction performed by the agent with himself or herself, either in his or her own name or in representation of a third party, is annulable unless the principal has specifically agreed with it or the transaction excludes the possibility of conflict of interest due to its nature.” Thus, if an agent contracts with themselves without the specific approval of the principal, the

contract formed will be annulable. The agent cannot avoid this rule by arranging for a substitute agent to take over his powers for the purpose of forming the contract, because Article 252(2) specifically prohibits this. The reason this rule exists is so that the agent can't take unfair advantage of his position of trust to benefit himself at the principle's expense. It is also so that the principle feels that he can trust his agent to only do what is best for the principle, and not what is best for the agent. If the principle didn't feel that he could trust his agent, he probably would not use an agent in the first place. Since using an agent can be valuable because it allows good transactions to happen that would not be able to happen without an agent if the principle was unavailable, we want to encourage people to use agents to make as many transactions as possible. To encourage the use of agents, we have laws like this one that limit the actions agents can take to make sure that principles know that they can trust them.

#### *Relevant Civil Code Articles*

Article 249: Effects of representation

Article 250: Unwillingness or will-related faults and relevant subjective states

Article 251: Justification of the powers of the agent

Article 252: Transaction with oneself

Article 253: Power of attorney

Article 254: Legal capacity of the proxy

Article 255: Substitution of the proxy

Article 256: Extinguishment of the power of attorney

Article 257: Protection of third parties

Article 258: Return of the representation papers

Article 259: Representation without powers

Article 260: Abusive representation

#### *Examples and Discussion Questions*

##### Example 1

Priscila Sarmiento is a popular singer on tour in Australia for two months. In her spare time, Priscila gives singing lessons to those she thinks are talented enough to benefit from her vocal advice. Just before she left Timor for her tour, Priscila arranged for her friend Lyli Viegas

to run her vocal training business for her while she was away. Since Priscila trusted Lyli's judgment in the selection of clients, Lyli was authorized to represent Priscila in any agreements that needed to be made to get new clients for the business. Priscila also authorized Lyli to hire her "trusted friends" to serve as substitute agents for Lyli when necessary.

Lyli completed two contracts for the vocal training business while Priscila was away. One contract was with a talented young man named Amandio. The other was with Lyli herself. Lyli had been secretly wanting to train with Priscila for several years, so she thought that this would be the perfect opportunity to surprise Priscila by becoming a client.

When Priscila returned from her trip, she was not happy with the job Lyli did as an agent. She calls you, her lawyer, on the phone and asks you whether she is legally bound by the contracts Lyli entered into while she was away.

### Discussion Questions

1. What is your answer to her question?
2. Does it change your answer to know that Lyli hired her good friend Marce to serve as a substitute agent in making the contract for Lyli to become a client?

### Answers

1. Article 249 of the Timor-Leste Civil Code states that "[a] legal transaction performed by the agent on behalf of his or her principal, within the powers granted to him, produces its effects in the legal sphere of the latter." That means that Priscila is as bound by the agreements as she would be if she had made them herself. However, the contract with Lyli is annulable, in accordance with Article 252, since it was made "by the agent with himself or herself," without the principal's specific approval.
2. The fact that Lyli hired a trusted friend to act as Priscila's agent for the self-interested transaction does not change the outcome. Article 252 states that "a transaction performed by the person who has been appointed a substitute agent is deemed to have performed by the agent himself or herself." This means that Lyli's choosing a substitute agent for the self-interested contract is the same thing, legally, as if she had made the agreement herself.

### Example 2

Vanio Costa owns a café called Vanio's Haven. The café is known for its fantastic vanilla lattes, so Vanio has to keep a lot of milk in stock to ensure that he can always make the café's



most popular drink. In order to ensure a steady supply of milk, Vanio asks his assistant, António, to make an exclusive one-year supply contract with Anisha Borges, a nearby dairy farmer. An exclusive supply contract is a type of contract where the buyer agrees to get all of his supply of a product from only that one supplier. In exchange for guaranteeing that the buyer will buy a lot of the product, since he agreed to not get it anywhere else, the supplier normally gives the buyer a very good price for the product. In this case, the provision for exclusivity in only buying milk from Anisha will ensure that Vanio receives a good price for the milk.

However, Vanio has a secret plan to obtain cheaper milk from a different milk farmer whenever he is able to. Vanio believes that because António is acting as his agent, António will be able to make a contract with Anisha that will be enforceable if Anisha tries to stop selling him milk in the next year. He also believes that Anisha will not be able to prevent Vanio from buying milk from other farmers since António made the contract bona fide, in good faith.

#### **Discussion Question**

Is Vanio correct about being protected from a possible future breach by Anisha while also being able to breach his side of the agreement?

#### **Answer**

Vanio is not correct. Article 250(1) says that where the will of a principal has been the will that determines the agreement, it is the will of the principal that must be considered in determining whether there has been a will-related fault. It is only where the principal has left discretion, or choices to be made, to the agent that the agent's will matters. Therefore, since Vanio was the one who decided that the contract would be exclusive, and António just did what Vanio said, Vanio's will-related fault is the one that matters. Because Vanio's will was not bona fide because he intended to cheat, it would likely prevent the contract from being formed. Moreover, 250(2) states that "[a] principal acting in bad faith shall not benefit from a bona fide agent." Therefore, even if Vanio's will had not been the one that decided the issue of exclusivity, but it was António's will, Vanio would still be prohibited by law from using António's bona fide will to form a contract, because Vanio still had bad faith. To allow Vanio to "hide behind" António's bona fide would allow him to benefit from it, which violates the rule.

## **8. Conditions**

### *Overview of Conditions in Contract Formation*

## SECTION OBJECTIVES

- To understand that conditions can be used to allocate the risks from uncertain future events between contracting parties.
- To explore different reasons for regulating conditions, including protecting the rights of contracting parties and keeping public order.
- To understand when contracts are void on the basis of including certain types of prohibited conditions.

### What is a “condition”?

Article 261 of the Timor-Leste Civil Code provides the legal basis for conditions:

#### Article 261 Concept of Condition

The parties may decide to make the effects of a legal transaction, or its resolution, depend upon an uncertain future event. In the first case, the condition is called suspensive. In the second, the condition is called resolutive.

According to Timor-Leste Civil Code Article 261, a “condition” is an optional contract clause, or term, that makes whether or not a contract is valid “depend upon a future and uncertain event.” The purpose of conditions is to allow contracting parties to decide what will happen if particular events occur. Conditions are therefore used to decide which party to a contract must accept, or “bear,” the risk that a particular event might or might not occur. For example, in a contract for the delivery of coffee beans from Timor-Leste to Australia, there might be a clause that says that the seller will bear the risk of loss if the ship delivering the coffee beans sinks. While there are several ways to express who has this risk in the contract, one way is to include a condition in the contract that releases or frees the buyer from her obligation to pay the seller if this ship sinks. Alternatively, if the buyer is the one who has to bear the risk of loss, then the seller could be released from his obligation to deliver the coffee beans if the ship sinks.

There are two types of conditions, suspensive and resolutive. Suspensive conditions are conditions which mean that the contract will not be enforceable until a condition is met and will only be enforceable if the condition is met. So in a suspensive condition the contract, or part of the contract, is only enforceable if the occurrence of an uncertain future event happens. This does

not mean that the whole contract is not binding, as neither party has the right to cancel the contract, it only means that the promises are not enforceable until later if an event happens. For example, if two parties agree that one party will buy a specific cow, that is now only a young calf, from the other party in one year if that cow survives and grows up to be an adult; that is a suspensive condition. Neither party can cancel the contract, but if the cow dies before she grows up, then the contract is cancelled and neither party can enforce the contract. A resolutive condition, on the other hand, is when the contract functions completely right away, and is fully enforceable, but that it is then later cancelled if something else happens. Resolutive conditions thus have the power to terminate obligations created by contracts upon the happening of a future, uncertain event. For example, if two parties agree that one party will buy a specific calf now and take it home, but that if it dies within a year of the sale the contract is voided and the buyer of the cow gets his money back from the seller; that is a resolutive condition. The difference is that suspensive conditions only become enforceable if an event happens, while resolutive conditions only become unenforceable and void if an event happens.

*What are the rules for transaction conditions?*

Contracts Including Unlawful or Impossible Conditions are Void

Read Article 262 carefully and try to understand how unlawful and impossible conditions can affect obligations arising from contracts:

Article 262  
Unlawful or Impossible Conditions

1. Any legal transaction subject to a condition contrary to law or public order, or offending morality, shall be void.
2. Any transaction subject to a suspensive condition that is physically or legally impossible shall also be void. If it is a resolutive condition, it shall be deemed not written.

In a contract for the sale of a car, it is not legal for the parties to include a condition that the buyer's obligation to pay is conditional upon new wheels being successfully stolen from another vehicle for the car. In fact, the inclusion of such a condition would make the entire contract void. This is because of Article 262 of the Timor-Leste Civil Code, which says that "any

legal transaction subject to a condition contrary to law or public order, or offending morality, shall be void.” Since theft is illegal, and therefore “contrary to law”, a contract conditioned upon theft is void.

Contracts may also be voided by the inclusion of suspensive conditions that are “physically or legally impossible,” according to Timor-Leste Civil Code Article 262. That would be unfair for one of the parties. If in the same contract of purchase of a cow, the suspensive condition is that the cow turns red in one year, the contract is void. The cow will never turn red and it is unfair to have the other party bound by such an impossible condition. In case this condition is resolutive, it shall be deemed as unwritten. If the contract would produce effects until the cow turns red – and it is impossible that it turns red – this condition shall be deemed as non-existent.

### Rules for Pending Conditions

Article 263  
Pending Condition

Anyone undertaking an obligation or disposing of a right subject to a suspensive condition, or acquiring a right subject to a resolutive condition, should act according to bona fide rules while the condition is pending, so as to avoid compromising the full rights of the other party.

A “pending condition” is a condition that has not yet taken effect because the event it is dependent upon has not yet occurred. When a suspensive condition is pending, this means that a party has agreed to undertake an obligation or to dispose of a right only if the event happens. When a resolutive condition is pending, alternatively, the party has gained the right and the obligation already but will be able to cancel it and undo the contract if the event happens; the contract produces effects until the event happens (condition). In both cases, the law regulates how contracting parties can act while conditions are pending in order to protect the rights of parties who stand to gain from conditions taking effect.

Article 263 of the Timor-Leste Civil Code says that anyone who will undertake an obligation or give up a right if a suspensive condition takes effect, and anyone who will be able to cancel a right or obligation that they have already acquired if a resolutive condition takes

effect, must “act according to bona fide rules while the condition is pending,” in order to “avoid compromising the full right of the other party.” This is a complex concept, so to understand it, try to think through the following example:

A car buyer makes a contract with a car seller that includes the following condition: “The buyer will have an obligation to pay the seller 2,000 US dollars upon the delivery of the car to the buyer’s house.” This is a suspensive condition because the buyer only has to pay for the car in the event that the car is delivered. At the time the contract was made, the buyer lived in Dili, just a few kilometers away from the seller. The day after the contract was made, and before the car was delivered, the buyer moved to Singapore and bought a house. If the pending condition is the only legal issue in this case, what happens to the contract?

- The key issue is that the condition does not include the address of the house, but only says that the delivery destination is the “buyer’s house”. This example highlights the need to draft conditions clearly and to thoroughly explain the parties’ intentions.
- The seller is probably safe from liability, and probably is not in breach of contract for not delivering the car to Singapore. That is because the court would probably rule that the buyer violated Article 263 of the Timor-Leste Civil Code by acting against bona fide rules while a suspensive condition was pending. This is because the buyer compromised the full rights of the seller to payment for the car by significantly increasing the cost of delivery of the car, which was required for the buyer’s obligation to pay to take effect. Also, this could be seen as a change of circumstances under which the contract was formed, pursuant to Article 243 (2).

#### Rules for Determining Whether the Condition Applies

**Special Note:** Whenever you are dealing with a contract containing conditions, you should reference Civil Code Articles 264 and 265. We don’t explain those articles here because they cover areas that we do not cover in this textbook, but they are legally important to know.

Article 266  
Applicability and Non-Applicability of the Condition

1. Certainty that the condition cannot apply corresponds to its non-applicability.
2. If the applicability of the condition is impeded, against bona fide rules, by the person who loses from it, the condition is deemed applicable. If it is provoked, in the same terms, by the person who benefits from it, it is deemed not applicable.

For a contract with a condition to produce effects, the occurrence of the event on which a condition is dependent, or required for the condition to happen needs to be verified. Article 266 identifies the two situations where it might be hard to verify the occurrence of conditions: when there is certainty that it is impossible to verify the occurrence of the condition and when the verification of the condition is provoked, against bona fide rules, by the person who would benefit from its verification. This means that if a person who would benefit by an uncertain event does a bad faith thing to make the event happen, then we don't follow the condition and don't let the person who did the thing in bad faith to benefit. Article 266 also identifies a situation where a condition is deemed applicable even though the event on which it is dependent has not occurred. Article 266 says that when the verification of the condition is impeded by the person who benefits by the event not happening, against bona fide rules, the condition is deemed to have occurred. For example, imagine that a buyer gets a cow from a seller with the condition that he will only have to pay for the cow if the cow lives for a full year while he has it. If after 11 months the buyer kills the cow in order to not have to pay the seller for it, he would be considered in violation of bona fide, or good faith, rules. In this case, even though the contract had a required condition that it said would have to happen before the buyer had to pay for the cow, and that condition didn't happen, the court will say that the condition has occurred anyway. Because the buyer showed bad faith in making the condition not happen by killing the cow to cheat the seller, the court will act as though the condition actually did happen and will make him pay the seller just the same as he would have had to pay if the cow had lived for a full year. This makes sense because the court does not want to reward the buyer for doing something bad or to let him get away with cheating the seller.

Look at the following example, and for each event described, try to figure out whether the condition applies:

### **Example**

A contract for the sale of a boat includes a resolutive condition that says, “if the boat sinks before it is delivered to the buyer, then the buyer will be released from the contract and he will be given back the money he has paid to the seller.” Assume that there are no legal issues with the contract other than whether or not the condition occurs.

Event 1: Before the boat is delivered to the buyer, a terrible storm sinks it.

Event 2: Before the boat is delivered to the buyer, the buyer decides that he does not want the boat. The buyer sneaks onto the seller’s property and cuts holes into the bottom of the boat, causing it to sink.

### Answer:

Event 1: Event 1 would cause the condition to apply and the seller would have to return the money the buyer gave him for the boat. Event 1 would apply because the event on which the condition was dependent, the boat sinking, occurred naturally.

Event 2: This event would cause the condition to be non-applicable. Unlike event 1, event 2 was caused by the buyer against bona fide rules. Because of this violation of good faith, under Article 266 the condition would not apply and the buyer would not be able to get his money back from the seller. He would also probably face criminal charges.

### What happens to transactions when there is a problem with their conditions?

As previously explained, the effects of faults in conditions on the validity of declarations depend upon the type of fault and on other factors as well. Here is a summary of what happens to transactions when there is problem with their conditions:

- **Unlawful or Impossible Conditions:** The presence of unlawful conditions, either suspensive or resolutive, makes contracts void. Impossible suspensive conditions also make contracts void, but impossible resolutive conditions only make the condition itself disappear, as if the condition was not even written.
- **Pending Conditions:** While conditions are pending, contracting parties must avoid compromising the full rights of other party by acting in accordance with bona fide rules. Acting against bona fide rules may lead to the condition being voided by the court.
- **Non-verifiable Conditions:** If for reasons attributable to one of the parties, it is impossible to verify the occurrence of the conditions or if one of the parties has provoked the verification of the condition, parties shall act as if it had not occurred.

### Relevant Civil Code Articles

Article 261: Concept of Condition

Article 262: Unlawful or Impossible Conditions

Article 263: Pending Condition

Article 264: Pending Condition: Conservatory Acts

Article 265: Pending Condition: Dispositive Acts

Article 266: Applicability and Non-Applicability of the Condition

Article 267: Retroactivity of the Condition

Article 268: Non-Retroactivity

Article 269: Term

Article 270: Term Calculation

### Examples and Discussion Questions

#### Example 1

Two farmers, Tomás and José, agree to become partners to reduce their supply costs and to provide protection against damage to their crops. Part of their partnership agreement requires them to purchase 250 kilograms of seed on October 20<sup>th</sup> and contains a condition that says, “in the event that rainfall for the months of December and January is forecasted to be less than 80% of the average rainfall for those months, the partners will be released from their obligations to purchase the agreed amount of seed.”

#### **Discussion Questions**

1. What type of condition is described in the example above?
2. In the farmers' partnership agreement, what is the event on which the condition is dependant?
3. Why do you think the two farmers included such a condition in their partnership agreement?
4. Do you see any problems with the condition?



## Answers

1. The example above describes a resolutive condition, because the two farmers' obligation to buy seed comes into effect at the same time as the partnership agreement, and the occurrence of the event, a forecast of less rain, cancels those obligations.
2. The event on which the condition is dependant is the forecasted rainfall for the months of November and December falling below 80% of the average rainfall for those months.
3. There could be many reasons why the farmers included this condition in their partnership agreement. A likely reason is that drier weather leads to smaller harvests and Tomás and José might have been unwilling to invest their time and efforts in growing crops with such low expected yields. Another possible reason is that the risk of losing the entire crop in such dry conditions could have been too high for the farmers to bear. You might ask, why did Tomás and José make the contract in this first place then? Why not simply wait until October 20<sup>th</sup> and make a purchase together? Again, there could be many reasons for creating the contract in advance, but a likely reason is that the partnership agreement probably included more than just the joint purchase of seed. For example, the farmers might have wanted to purchase fertilizer together in September, so they simply created one contract to govern all of their business transactions and used different conditions for different parts to add flexibility to the agreement. Just because one part of the contract, the part about purchasing seed, might be cancelled by one condition, doesn't mean that the full contract, including other parts about purchasing fertilizer, is cancelled.
4. One key problem with the condition is that it is not specific enough in describing the event that terminates the two farmers' obligations to buy seed. For example, we do not know who determines whether forecasted rainfall is below 80% of the average. Different organizations may forecast rainfall differently and provide different estimates of average monthly rainfall. It would have been a good idea for the lawyer to ask his or her clients to include a specific organization's prediction as the one that would make the condition have effect. The condition also does not say what happens if the forecast changes between September and October. The court would be left to decide both which organizations prediction matters, and at what date, by interpreting what the parties meant.

### Example 2

Paula owns a restaurant, called Palma Café, and Roberto wants to rent the restaurant on the night of June 26<sup>th</sup> for a big party to celebrate his sister's return from Hong Kong. Paula is concerned that Roberto's guests will damage her restaurant, so she includes a condition in their rental agreement that states, "in the event that any property of Palma Café is damaged on the night of June 26<sup>th</sup>, Roberto Morena will have an obligation to pay Paula Santos the full cost to replace all of the damaged property."

### Discussion Questions

1. What kind of condition is described in the example above?
2. Imagine that on the night of June 26<sup>th</sup>, one of Roberto's guests knocks over a lamp in Palma Café that is property of the restaurant and breaks it. Paula replaces the lamp the next day for 30 US dollars. What happens?
3. Now imagine that Roberto's party is set to begin at 8 p.m., but at 7 p.m., Paula sets fire to the restaurant and it is completely destroyed. Does Roberto have an obligation to reimburse Paula for the damage? Why or why not?
4. Consider what would happen if Roberto's party started at 8 p.m. and at 9 p.m., a thunderstorm started and Café Palma was hit by lightning and burnt to the ground. Would Roberto have an obligation to reimburse Paula for the replacement of the restaurant?

### Answers

1. The example describes a suspensive condition because Roberto's obligation to reimburse Paula is suspended until any property of Palma Café is damaged on the night of June 26<sup>th</sup>.
2. This is a clear case of the condition becoming applicable. On the night of June 26<sup>th</sup>, property of Palma Café was damaged, so Roberto has an obligation to pay Paula for the cost of the lamp's replacement, which was 30 US dollars. It is important that you understand that calculating replacement costs can be quite complex. However, the details of replacement costs and how they are calculated is something that is not explained in this section, so we will not go into very much detail about it here. For example, imagine if Paula had decided to buy a bigger, more expensive lamp to replace the old one. Roberto would still have an obligation to reimburse Paula for the replacement of the lamp, but Roberto would not owe Paula the full cost of the much nicer lamp. How much exactly he would owe is a complex question for the courts to decide.
3. No, Roberto would not have an obligation to reimburse Paula for the damage because the condition would be non-applicable. According to Article 266 of the Timor-Leste Civil Code, a condition is non-applicable when it is provoked, against bona fide rules, by the person who would benefit from its applicability. Since Paula is the one who would benefit, and she provoked the condition's applicability by purposefully damaging Café Palma the night of June 26<sup>th</sup>, the court would deem the condition non-applicable and Roberto would not have any obligation to reimburse Paula for the restaurant's replacement. Paula would also likely be convicted of a crime.

4. Under a strict interpretation of the condition, Roberto would have an obligation to reimburse Paula for the replacement of the restaurant. Recall that the condition stated, “in the event that any property of Palma Café is damaged the night of June 26<sup>th</sup>, Roberto Morena will have an obligation to reimburse Paula Santos.” The condition did not limit Roberto’s liability, or responsibility, to damage caused by him or his guests. Because not having any limit on his responsibility for damage was extremely risky for Roberto, Roberto should have demanded a limit to his liability in the contract. Still, he may be able to avoid paying for the full restaurant even though his contract was not well drafted because this event is considered a force majeure event.

### Example 3

Imagine that Timorese champion marathon runner Augusto Ramos Soares enters into a sponsorship agreement with Timor Telecom in September 2011. Sadly however, in December 2011, Ramos Soares is injured in a terrible car crash and breaks his leg. Because of the injury he will not be able to run for at least a year.

### **Discussion Questions**

1. Imagine that the sponsorship agreement between Ramos Soares and Timor Telecom said; “If Augusto Ramos Soares wins the 2012 Dili Marathon, Timor Telecom will provide Augusto Ramos Soares with 10,000 US dollars per year for five years in exchange for the use of Ramos Soares’ image in Timor Telecom’s advertisements.” What effect would Ramos Soares’ car accident have on the contracting parties’ obligations?
2. Now imagine that the sponsorship agreement had instead said, “Timor Telecom will provide Augusto Ramos Horta with 8,000 US dollars annually for five years in exchange for the use of Augusto Ramos Soares’ image in Timor Telecom’s advertisements. Also, if Augusto Ramos Soares wins the 2011 Dili Marathon, then Timor Telecom will provide Augusto Ramos Soares with a 2,000 US dollars annual bonus for five years.” What effect would the car accident have on the obligations of the contracting parties?

### **Answers**

1. The condition in this case is suspensive and it is dependant upon Augusto Ramos Soares winning the Dili Marathon in 2012. Unfortunately he is physically unable to compete in the Dili Marathon in 2012 after breaking his leg. Article 262 of the Timor-Leste Civil Code states that any transaction that is subject to a suspensive condition that is physically impossible is void. Since the car accident makes it impossible for him to win the race, the entire sponsorship agreement void.

2. In this case, the sponsorship agreement as a whole is valid, so Timor Telecom still has an obligation to pay Augusto Ramos Soares 8,000 US dollars annually for five years and Augusto Ramos Soares still has an obligation to permit Timor Telecom to use his image in their advertisements. The second part of the agreement, with the condition that they will pay him 2,000 US dollars annually as a bonus if he wins the 2012, is a suspensive condition. Since he will not be able to run the marathon, only this part of the agreement is void, while the rest of the agreement is unchanged.

## IV. NULLITY AND ANNULABILITY OF THE LEGAL TRANSACTION

### SECTION OBJECTIVES

- To understand the reasons nullifying or annulling a contract.
- To know how a party can annul a contract as well as the impact of the annulment.
- To be able to differentiate between contract annulment and modification.
- To know how to restore an annulled contract.

#### 1. What do nullity and annulment mean?

As discussed earlier, the difference between nullity and annulability is very important. Nullity means a contract is void or without force because it violates a legal principle. A null contract has no legal effect or impact and is not binding. It is as though no contract ever existed and the agreement is nothing. Null contracts produce no effect whatsoever. These are “born dead.” Any party, including the court, may claim that a contract is null based on a reason from the Civil Code.

Annulability is different. An annulable contract is one that can be cancelled or can be fixed. An annulable contract produces some effects but it is damaged or flawed. Here, the contract is “born ill” and it can either be saved, or some people have the right to chose to “kill” it. Unlike with nullity, only an interested party, meaning a party directly affected by the contract, can try to annul a contract.

The difference between nullity and annulability is important for several reasons. Some of the reasons the differences are important are included below, though these are not all of the reasons:

- 1) A null contract will not be enforced by the court even if all parties want the court to enforce it. An annulable contract will be enforced unless one of the parties who is allowed to annul it chooses to annul it within a certain amount of time.
- 2) A null contract can be declared null by the court at any time, even long, long after it is made. An annulable contract stops being annulable if it is not annulled after a certain amount of time and eventually becomes fully binding just like a normal contract. This amount of time changes depending on the situation, but can be found in the civil code.

- 3) Contracts that are nullified are considered completely dead and it cannot be fixed. Sometimes a completely new contract can be made that does something similar to the nullified contract, but in a way that is legal and correct, but it will not be the same as the old contract and the two are considered completely legally separate. However, with a contract that is annulable, it is possible sometimes that instead of annulling the contract, the parties can decide to fix the contract. In this case, some of the contract stays the same, but the broken parts are changed or are just removed from the rest of the contract and only those parts are cancelled. This is not a completely new contract, but the same contract that has been modified or changed.
- 4) For a contract to be null it normally has to be made in a way that goes against very strong legal principles or against the law. For a contract to be annulable it normally only needs to be a small amount against legal principles, principles of fairness, or for there to be a mistake or error in its drafting that is serious.
- 5) The articles of the civil code provide only for annulment in some circumstances and only for nullification in other circumstances. Therefore, it is very important that lawyers understand when the solution is annulment and when the solution is nullification, since they are not the same and have different consequences.

This section explains the impacts of nullification and annulment, contract confirmation, reduction and conversion, and dissolution based on changed circumstances.

## **2. Why would a contract be null or annulable? What are the rules for nullity and annulability?**

A contract is null when it is made in a way that violates the law. For example, a contract for the sale of a child to be a labourer or to be trafficked is against the law, and is null and void in all circumstances. Another example would be a contract for the sale of illegal drugs or weapons. This contract is completely null and unenforceable. The court will not even consider any of the rights or responsibilities that are put in as part of this contract. As well as nullifying the contract, in many of these cases though not in all of the cases, the parties involved can be prosecuted for crimes and sent to prison.

A contract is normally annulable when the law allows one party, or sometimes both parties, to either cancel the contract or to keep the contract if they want to. There are several reasons for annulment: excessive or unjustified gain in usury transactions, criminal usury, mistake, misrepresentation, and duress or coercion. These will be explained in more detail in the next section.

The section below explains different reasons for nullity or annulment as well as who can seek annulment based on the different reasons. Articles 273-275 provide several reasons for annulling or modifying a contract based on exploitation or legal violations.

### Exploitation

Article 273 of the Code states that a contract made to take advantage of another party's weakness is annulable.

#### Article 273

#### Usurious interest-bearing transactions

1. Legal transactions are annulable, on grounds of usury, when a person takes advantage of the need, inexperience, irresponsibility, dependence, mental condition or weakness of character of another person and obtains, for himself or herself or a third party, the promise or the concession of excessive or unjustified benefits.
2. The special arrangement laid down in Articles 494 and 1066 is safeguarded.

If one person makes a contract to gain unjust, or unfair and unreasonable benefits by exploiting another person's disadvantaged situation, then the contract is annulable. For example, if an experienced businessman convinces an inexperienced young fisherman to borrow money to buy a boat with an interest rate of 200% on the loan, by tricking him into thinking it is a good deal, when the normal interest rate for this type of loan is only 15%, then the fisherman could request that the Court annul the contract on the basis of Article 273. The Court would determine if the businessman received excessive benefits, meaning too much profit when the profit is unfair, by taking advantage of the young fisherman's weakness or inexperience. However, it is important to make it clear that the court might not cancel this contract even though it is unfair. Courts normally annul contracts if the way that the stronger party got the weaker or inexperienced party to agree is unfair; however if the way that the contract was made was fair, the court will probably not cancel a contract just because the result inside the contract is unfair.

The difference here is between what is called “substantive” fairness and “procedural” fairness. “Substantive fairness” in this case means the fairness of the stuff inside of the agreement including the obligations, responsibilities, and rights that are being traded, like how much interest the businessman will get. “Procedural” fairness in this case means the way that the contract was made and negotiated and talked about, like the way that the businessman convinced the fisherman to make the contract. An example of procedural unfairness would be if the businessman lied, used too much pressure, didn’t make it clear to the fisherman that he didn’t have to sign the contract, tried to hide that the fisherman could get a loan somewhere else, wrote the contract in a language that the fisherman didn’t understand, wrote some parts of the agreement in words that were too small to read, or something like that. The two ideas of procedural fairness and substantive fairness are separate. It is possible for a contract to be procedurally unfair, but substantively fair. For example, if the businessman lied and said that the normal interest rate was 200%, told the fisherman that he had to sign the agreement or he would beat him up, and wrote the contract in very small letters in a language that the fisherman didn’t understand that would be procedurally unfair. But if after all these threats and procedural unfairness the interest rate the businessman forced the fisherman to agree to was a very good one, just 10%, then the contract would be procedurally unfair, but substantively fair. It would be procedurally unfair because the way that the businessman got the contract was unfair, but substantively fair because the interest rate of only 10% is much better than the interest rate of 15% that is the best that fisherman could have gotten somewhere else. It is also possible for a contract to be procedurally fair, but substantively unfair. For example, imagine the fisherman went to the businessman and offered to pay 200% for a loan but the businessman said that 200% was a lot of interest and that if the fisherman went somewhere else he could get a better interest rate. Now imagine that even after the businessman told the fisherman that he could get a better rate somewhere else the fisherman said he didn’t care about the interest rate and would still rather pay 200% interest to the businessman. After this discussion, and with no pressure from the businessman the contract was written out in big clear letters using clear words and a language both the fisherman and the businessman understood and the fisherman happily signed it. In this case the contract would be procedurally fair but substantively unfair. It is procedurally fair because the fisherman was not tricked or cheated or exploited or taken advantage of; it is substantively unfair because 200% interest is a lot more than the normal 15% interest.



Like with the difference between annulment and nullification, the difference between the two types of unfairness is also very important. It is important because courts like to annul contracts that are procedurally unfair and will annul these types of contracts easily and quickly. However, courts do not like to annul contracts that are only substantively unfair, if they are not also procedurally unfair. If a contract is made in a way that is procedurally fair, but it is substantively unfair, it will have to be VERY substantively unfair before the courts will annul it. The reason for this is that the court respects people's freedom and their right to make their own decisions if their decision is free. If a contract is procedurally unfair than the person who makes the contract is not completely free when they agree to it. If someone is tricked or pressured they are not really making a free decision. However, if the contract is procedurally fair, then the person made the decision to make the contract freely and their decision should be respected. In the case of the fisherman, if the contract was not made in a way where he was tricked or pressured in any way, even if it is a substantively unfair contract, the court will probably respect it. It will respect it because the court thinks that the fisherman understood his reason for making the contract better than the court, and because he is free, they don't want to disrespect his decision or cancel his "freedom of contract" to make his decision for him. Maybe the fisherman made the substantively unfair, but procedurally fair, contract with the businessman because he liked and trusted that businessman and wanted to give him good business and help him make money. Maybe he made the decision because he didn't like or didn't trust the other businessmen who could give him loans as much. It doesn't matter. The only thing that matters is that even if the court thinks the fisherman's contract was unfair and the fisherman made a bad decision by making it, as long as the fisherman was competent and the procedure was fair, the court will probably respect that the fisherman is an adult who is free to make his own decisions, even bad decisions. The courts job is to respect the fishermen's freedom, not to act like his parent telling him what to do and making his decisions for him.

Most of the time, contracts are not substantively unfair unless they are also procedurally unfair, because most of the time parties don't want to make bad deals if they are free to make better deals. However, knowing the difference is important because sometimes something will look like it must have been procedurally unfair even when it wasn't, and in those cases the court must be careful to not assume, or think without looking closely at the situation, that it was procedurally unfair just because the contract looks substantively unfair. For example, imagine

that the fisherman was very, very poor and had a bad reputation for being dishonest and not doing things he promised to do. Also imagine that where he lived there were not very many businessmen who gave loans. Now, imagine that the fisherman went to every place where it was possible to get a loan in his area but no one would give him one. They would not give him one because he was so poor that if anything small happened to him, or his boat, he would not be able to pay the loan back. Also, because he was so poor, he didn't own anything that the lender could ask the courts to force him to sell to get the lenders money back. Finally, because he had a bad reputation, the other lenders thought that he would probably try and cheat and never pay the loan back and just keep the money. Now let's imagine that the fisherman finally went to the last businessman and asked for a loan. The businessman was afraid that because the fisherman was poor, and because he had a bad reputation, that he might not get his money back from the fisherman. Because the fisherman knew that the businessman didn't want to give him a loan, the fisherman decided to make it a better deal for the businessman by offering to pay him much more interest, 200%, than normal. The businessman then agrees to give the fisherman the loan because the extra profit makes it worth taking the extra risk that the fisherman will not pay the businessman back. In this case, if the fisherman had not offered to pay so much interest, no one would have freely agreed to lend him money, because he was too risky. If the court decided in this case that the 200% interest was too high, and it was unfair, then in the future, no businessman would agree to lend money at 200% interest, because then the court would cancel it. What that would mean, is that the fisherman would never be able to get a loan from anyone. This is a bad solution, because if the fisherman is happy with a loan with 200% interest, and so is the businessman, then there is nothing wrong, and because they both were free when they agreed, it wasn't really unfair. The law wants to allow people to make all contracts that are free as long as they aren't illegal. If the court starts to annul contracts that were made when both parties were free, then people will not be able to do things that they want to do, and the government will be taking away their freedom. That is why the courts do not like to annul contracts that are only substantively unfair, if they were procedurally fair.

The courts, because they like to encourage freedom, do not like contracts that are not free. Procedurally unfair contracts are not really free or fair. It is mostly to stop procedurally unfair contracts that Article 273 was made. It works in two different ways, one way is to discourage unjust contracts and the other way is to permit a remedy, or solution, in case a party

negotiates an unjust contract. First, it discourages unjust contracts because businessmen know that they can get into legal trouble for gaining excessive benefits from unfair contracts. Because they don't want to get into this trouble they probably will be less likely to make these unfair contracts in the first place. Second, Article 273 gives the disadvantaged person a way to avoid having to pay the unfair amount.

To serve these purposes, Article 273 gives the courts broad authority to annul a contract based on a variety of circumstances. Therefore, the courts must carefully evaluate each situation to see if the contract exploits a needy, inexperienced, weak, or dependent person. Once the Court annuls the contract, the Court must decide what to do if there has been partial performance, meaning if some of the parts of the agreement have already been done. Should the money or product be returned to the injured person? Should there be an alternative way to compensate or undo some of the damage to the injured person? These questions will be answered in more detail later on.

#### Contract Modification

Instead of asking for an annulment, an injured party may choose to request a different type of solution to an unjust contract. Under Article 274, the injured party may request that the Court change the contract to make it more equally fair to both parties.

#### Article 274

#### Modification of Usurious Interest-Bearing Transactions

1. Instead of annulment, the injured party may request that the transaction be modified in equitable terms.
2. When annulment is requested, the other party have the right to oppose the request and declare their acceptance to modify the terms of the transaction pursuant to the foregoing paragraph.

A party who has been the victim of an unfair contract has two options to solve the problem after the other party took advantage of them. The two options are that they can request that the Court either (1) annul the contract completely or (2) modify the contract to make the terms more equitable. "Equitable" here means equal or fair. In other words, the party can ask that instead of cancelling the whole contract, the court just change it in some way to make it fairer.

For example, imagine that Marco buys a motorcycle from a businessman and also rents a helmet for the weekend from the business man until he can go to Dili and buy his own helmet. Both the purchase of the motorcycle and the renting of the helmet are done in one contract. The businessman and Marco agree on a price for both the motorcycle purchase and the helmet rental and the businessman asks Marco to sign a contract that is written in Portuguese, a language which Marco doesn't understand and can't read. Marco asks the businessman what it says, and the businessman says that the contract just says that Marco agrees to purchase the motorcycle and to return the helmet at the end of the weekend. Marco then signs the contract. Unfortunately, what the businessman didn't tell Marco is that the contract also says that if Marco damages the helmet in any small way, Marko will have to return the motorcycle as well as the helmet at the end of the weekend, and will not get his money back. Marco then rides the bike into Dili where a rock that got knocked into the air by a passing truck cracks the windscreen on the helmet. After the weekend, Marco returns from Dili with his new helmet and the helmet he rented that now has a cracked windscreen. He then tries to return the helmet and offers to pay the businessman the cost to replace the cracked windscreen. The businessman then explains to Marco what the contract says about him having to return the motorcycle if he damages the rented helmet and then the businessman tries to take back the motorcycle that Marco bought from him. In this case, Marco could challenge the validity of the contract. He likely would argue that the businessman exploited his inability to understand the language of the contract and his trusting that the businessman had good faith in the agreement and was not trying to trick him. The Court would consider the circumstances in detail to decide if the businessman received an excessive gain by unjustly exploiting Marco. In this case, both because of how unfair the way that the businessman tricked Marco into signing the contract, and how unfair the contract was in requiring Marco to return a very valuable motorcycle for a not very expensive damage to a rental helmet, the court would likely rule that the contract was not valid. Once the court ruled that the contract was not valid, Marco would then have the choice to either request annulment or request modification under Article 274. If he prefers annulment of the contract, than the court will let him return the motorcycle to the businessman and the businessman will have to return Marco's money. But if he prefers modification, he could request permission to modify the part of the contract that required him to return the motorcycle if he damaged the helmet. He could, for example, modify that to instead say that he only has to pay to replace the damaged part of the helmet. Since this

modification is much fairer, the court would probably allow it. This means that the court would likely let Marco keep his motorcycle and only pay the businessman the cost of a new windscreen for the rental helmet. As demonstrated in Marco's case, Article 274 allows the injured party to have more options to resolve their unfair contract. It provides more flexibility to help fix injured parties' contracts that still have the potential to be beneficial.

### *Criminal Behavior*

Another grounds for contract annulment or modification is if the transaction includes criminal behavior. Article 275 provides the authority for annulment of usurious transactions that are also considered crimes.

#### Article 275 Criminal Usury

When the usurious transaction constitutes crime, the deadline for exercising the right to annulment or modification does not expire until the crime prescribes. If the criminal liability is extinguished, for any reason other than limitation of power to prosecute or a sentence in rem iudicatam passed in a criminal court of law, the said deadline shall start counting from the date of extinction of criminal liability, or the date of the sentence in rem iudicatam, unless counting must start at a later date by virtue of the provisions of Article 278, paragraph 1.

Article 275 permits a court to cancel or modify a contract that includes an unlawful, or illegal, act. It exists to discourage people from making unlawful contracts. The court generally has the right to cancel or modify the contract until criminal liability has ended. This means that the court gives the party who is the victim of the contract a longer time than normal to annul the contract. Remember that most contracts can only be annulled by a party within one year or the contract is not annulable and becomes binding like a normal contract. Article 275 makes a special exception for usurious contracts with unlawful acts, so that they can sometimes be cancelled later than a year. Usurious contracts may be annulled up to the expiration of the punishable period of the crime (statute of limitations). That means that if the crime is punishable for 5 years after its occurrence, the contract may be also annulled during these whole 5 years.

### *General Nullity and Annulability*

Articles 276-278 state the general rules on nullity and annulability. Any “concerned person” can allege nullity: that a contract is null and void. This includes the court. If the allegation of nullity is true, then the court would declare the contract null, unenforceable, and without any legal force. In contrast, only parties with a legal interest in the contract can bring claims of annulability. Therefore a lot more people are able to claim nullity while fewer people can claim annulability.

Article 276  
General Provision

In the absence of a special regulation, the provisions of the following articles shall apply to the nullity and annulability of legal transactions.

Article 277  
Nullity

Nullity can be alleged at all times by any concerned person and may be, as a matter of procedure, declared by the court.

Article 278  
Annulability

1. Annulability may be alleged only by those people whose interest is established by law and only within one year following the cessation of the fault that constituted grounds for the said annulment.
2. Annulability may none the less be alleged, irrespective of any deadline, both by way of action and exception, provided that the transaction has not been concluded.

Article 277 on nullity and Article 278 on annulability state the guidelines for cancelling a contract. There are two ways a contract can be cancelled under the Code. First, a concerned person can allege nullity, and a court can declare the contract to be null and void. Second, a person with an interest in the contract that is established by law can petition the court to annul the contract. Normally to be considered a “person with an interest in the contract” the person must either be one of the parties to the contract or someone who is not party to the agreement but who benefits or losses from the agreement. To annul the contract, the interested party should make this request within a year of the end of the problem or reason for the annulment.

There are many reasons that a party may wish to annul a contract. In Article 273, the Timor-Leste Civil Code says that a party should have a “grounds” or “fault” as a reason for annulment. A reason for annulment may include one of the following reasons: mistake, deception or misrepresentation, and duress or coercion. A material mistake would be a reason for annulment because serious misunderstandings can confuse the entire meaning of the contract. If one party thought that they were trading one object in the trade, like a car, and the other party thought they were trading another object, like a truck, then it would not be possible to complete both understandings of the contract. For that reason, some significant mistakes regarding the meaning of the agreement can justify annulling the contract. If one party deceives the other party, the contract is also annulable on the basis of deception or misrepresentation.

Additionally, a party can annul a contract made under duress or coercive pressure. A court could apply Article 273 to a contract that provides excessive gain to the coercive party on the grounds that one of the parties contracted under unjust duress. To justify annulment, the mistake, deception, or coercion would have to be big enough to have a large and important effect on the responsibilities and obligations in the contract. If there are only small things in a contract caused by coercion it would mean that the contract should only be changed, not that it should be completely cancelled.

Finally, the difference between nullity and annulment in Articles 277 and 278 gives different ability to different people to cancel the contract. In the case of nullity, any “generally concerned” parties can ask the court to nullify the contract or even the court can declare the nullity itself without depending on anyone’s request (*ex officio*). In case of annulment, only the parties that the law has established as “concerned parties” may request annulment of the contract and may do so only in the subsequent year after the fault has been resolved or until the obligations are fully performed. Giving outside concerned individuals some influence gives a greater number of people the ability to share information with the court if there is an invalid basis for the contract.

Article 285 states that an unlawful transaction is a reason for nullification:

Article 285  
Transactions Performed Against the Law

Transactions performed against imperative legal provisions shall be void, save in those cases in which a different solution results from the law.

A contract is void when its goal or object goes against the law or is illegal. By voiding these contracts, Article 285 discourages people from agreeing to transactions that violate legal provisions. For example, a shipping contract to smuggle in illegal goods would be void because it would violate the law.

In sum, excessive or unjustified gain in usury transactions, criminal usury, mistake, misrepresentation, and duress or coercion all could justify annulment. An unlawful transaction justifies nullification.

**3. What does it mean to confirm an annulled contract?**

Contracts that may be annulment might be confirmed before annulment, saving the validity of the entire agreement.

Article 279  
Confirmation

1. Annulability can be remedied by means of confirmation.
2. Confirmation must be made by the person who has the right to revoke and is only effective after the fault that constituted grounds for annulability has ceased to exist and its author has knowledge of the fault and of the right to revoke.
3. Confirmation can be express or tacit and does not depend on any special form.
4. Confirmation is retroactively effective, even vis-à-vis third parties.

To confirm a contract means save a potentially annulable contract so that its flaw is corrected and annulment is avoided. The person who would be entitled to claim annulment is the one that has the right to confirm the contract. However, this is only possible once the reason for annulling the contract is known to all parties and it has been fixed. Confirmation has a retroactive effect, meaning that the contract should be considered as fully valid from its formation.



Additionally, Article 279 states that confirmation can be either implied or clearly stated. This means that parties can confirm their contract informally and regardless of any special form or official process.

#### **4. What is the impact of nullity and annulment?**

The decision to nullify or annul a contract applies retroactively. A retroactive effect means that anything already done under the obligations and requirements of the contract must be reversed and undone. This section explains the impacts of annulment and nullity on the contract as well as on the rights of third parties.

Article 280 states the full effect of a declaration of nullity or annulment:

Article 280  
Effects of the Declaration of Nullity and of Annulment

1. Both the declaration of nullity and the annulment of the transaction produce a retroactive effect. All that has been supplied must be returned and if the return in kind is not possible, then the corresponding value shall be paid.
2. If any party gratuitously disposed of anything that should be returned, and the return of the respective value cannot be actually made to the seller, then the buyer shall be liable in his or her place, but only to the extent of his or her enrichment.
3. The provision of Article 1191 and following articles shall apply to any of the cases laid down in the foregoing paragraphs, directly or by analogy.

Under Article 280(1), nullity and annulment both apply retroactively. Retroactive effect means that, if the parties already began performance, or doing what they promised to do under the contract, they must find a way to undo their performance. Article 280(2) says the parties would need to either return the items exchanged or pay in money the same amount as the value of the object. The retroactive effect can apply to both simple and more complex situations.

Imagine that a business person contracts to sell a home to Fabiola for money given over the course of five instalments, which are payments divided up over time so that not all of the money has to be given at once. Also imagine that Fabiola has already paid two payments when they annul the contract. In that case, the person she was buying the house from would have to pay her back the two payments that she had already made.

How would the above situation change if she had paid four payments and was already living in the house for two months? First, after annulment, the business person would return all four of the payments to Fabiola. Then, since Fabiola received value from living in the house for two months, it is likely she would need to pay the value of rent for those two months. This way, the owner returns the money value they received, and Fabiola, the buyer, returns the value she received from living there. In a contract annulment each party pays the other the value that they received.

### *Simultaneous Mutual Return*

You just learned that nullity and annulment apply retroactively to partial performance. Next the Code states that obligations to return payment should be fulfilled at the same time if possible.

#### Article 281 Date of Return

Mutual return obligations of the parties by virtue of nullity or annulment of the transaction should be complied with simultaneously, the rules governing the exception of non-compliance with the contract being extensive to the case in the applicable part.

When a contract is null or annulled, the parties must repay the value they received through the contract, either in the form of goods or payment. Under Article 281, parties should return goods and make repayments simultaneously. The purpose of this article is to ensure that the parties carry out annulment in a fair and reliable manner.

For instance, Jose and Roberto negotiated a contract to trade two boats. After they exchanged the boats, one party annulled the contract. Once the annulment takes place, they should plan to return the boats at the same time under to Article 281. Thus, Article 281 makes it less likely that one party will cheat the other.

*The Rights of Third-Party Buyers regarding real state or objects subject to registration*

As you may already know, real estate and some other objects are subject to registration (deeds). The main function of a registry of a land, for instance, is to keep third parties informed about the rights and obligations that relate to that piece of land.

Now think about a situation where Jose sells Roberto a house and then annuls the contract after Roberto has already resold the house to Miguel. For transactions involving registration, Article 282 protects third-party buyers' rights even if a contract is void or annulable. A third party buyer is someone who was not involved in the original contract who later bought the object that was covered in the contract. Article 282 protects the bona fide third party purchaser in most, but not all, contracts as long as they bought the item in good faith and did not know that the item was part of a different contract that was void or annulable. There are some specific instances in which it takes more than just good faith though to protect the third party purchasers right to possession. It is also worth noting that it is important that the third party only be protected if they bought the item in good faith. If the third party was protected without considering good faith it might be possible for two people to work together to keep something that they shouldn't be able to keep by reselling it from one to the other.

Article 282

Effects of Nullity or Annulment Towards Bona Fide Third-Party Buyers

1. Declaration of nullity or the annulment of the legal transaction concerning real property, or movable property subject to registration, does not diminish any rights paid for such property by a bona fide third-party buyer, if the acquisition was registered prior to the registration of the nullity or annulment action, or the registration of the agreement between the parties regarding the nullity of the transaction.
2. The rights of the third party however shall not be recognised if the action is proposed and registered within the three years following the conclusion of the transaction.
3. Any third-party buyer who, at the moment of the acquisition, ignored, without fault, that the transaction was void or annulable, is deemed bona fide.

In cases of objects like real property that require registration with the state, nullity and annulment do not change the rights of a third-party buyer who acted in good faith but only if the third-party registered the property sale before the lawsuit seeking declaration of nullity or annulment is filed. If the lawsuit is filed in the 3 years subsequent to the property sale, however,

the rights of the third party are not recognized. In this case, good faith is not enough; the buyer must also have registered the sale before the declaration of nullity or annulment and the declaration of nulidity or annulment must have come more than three years after the sale.

According to Article 282 (3), any third-party buyer who bought the item and registered it without knowing about the annullability is considered a bona fide buyer and is protected in his possession of the object provided that the transaction to be annulled is over three years old..

Now imagine the situation again where Jose had sold Roberto a house and then Roberto sold the same house to Miguel. What happens to Miguel’s rights if Jose annuls his contract with Roberto in an attempt to get his house back? Situations like this can occur for many reasons. People change their minds for personal reasons, their circumstances change, or people get new information. For Miguel, a court would have to decide what would happen to the house. If Jose sold the house to Roberto more than three years ago, and if Miguel registered the purchase of the house from Roberto before Jose started the action to annul the contract, than Miguel will be able to keep the house. On the other hand, if the sale from Jose to Roberto was less than three years ago, Miguel won’t be able to keep the house. Miguel also won’t be able to keep the house if he only registered his purchase after Jose filed papers to annul the contract, even if the contract was much longer than three years ago.

## **5. What is Reduction and Conversion?**

In some cases, canceling the full contract would either be too costly or unnecessary. For this reason, the Code gives parties several options for fixing a broken contract. First, they can remove the broken or damaged part of the contract under Article 283. Second, they can change the contract into a new and better one by putting it in a different form under Article 284. The term for modifying a contract to remove a broken or invalid section is “reduction.”

Article 283  
Reduction

Nullity or partial annulment does not require the invalidity of the entire transaction, unless it has been demonstrated that such act would not have taken place without the faulty part.

Reducing the contract by removing only the part that makes it invalid makes it possible to avoid cancelling the entire contract. Reduction permits parties to save the rest of the contract, which may still be useful and valid. For example, imagine two parties made a contract to ship a large amount of medicines from Singapore for sale in Timor-Leste. Now imagine that one type of medicine, because it can be used to make an illegal drug, is not allowed to be shipped into East Timor because of concerns that it might be used to help manufacture illegal drugs. In this case, even though the part of the contract for the drug that is not legal in Timor-Leste and needs to be nullified, the parties might benefit from maintaining the other provisions in the contract while removing only the part about shipping in that one medicine. If the law always required cancelling the entire contract based on one illegal provision, then parties might waste time trying to redraft a contract when they could just maintain the rest of the existing contract.

Like reduction, conversion is another way to deal with an invalid contract without full cancellation:

Article 284  
Conversion

The void or annulled transaction can be converted into another transaction of a different kind or content, maintaining the essential requirements of substance and form, when the purpose aimed by the parties makes it possible to assume that they would have wanted it, if they had anticipated the invalidity.

Conversion allows the parties to change an invalid transaction into a valid one. Like reduction, this allows parties to maintain the general purpose of their agreement. Hence, conversion has potential to save the parties from wasting time and effort. For example, imagine that a company made a contract with a construction firm to build a large hotel near the beach in Dili. Before the construction starts though, the parties realize that a year earlier the Parliament had passed a law saying that all new hotels must be located more than 200 meters away from the Ocean in Dili. In this case, the court would normally nullify the contract based on this legal fault. However, instead of declaring the entire contract null, it is possible that the court might allow the parties to convert the faulty agreement into a valid one. For example, the court might allow the parties to agree that the construction company will instead build a large apartment building on the same location, using mostly the same materials, and for the same amount of money.

Conversion under Article 284 in this case allows parties to change a nullified contract into a valid and useful one.

## **6. What does contract dissolution mean?**

Dissolution means to cancel the agreement. It generally has most of the same effects as either nullification or annulment. Timor-Leste Civil Code Articles 367-371 describe the contract dissolution process and outcome. To dissolve a contract, a party can make a declaration to the other party. Dissolution applies retroactively, except when the parties prefer do not want it to and agree that it will not apply retroactively.

The difference generally between dissolution and annulment is that dissolution does not require that there be anything wrong with the contract in the first place. While nullity and annulment relate to validity flaws, dissolution is merely the intention of the parties to terminate the contract.

It is possible that a party can include a clause in the original contract that says that the contract can be dissolved if any of the parties, or just some of the parties, want the contract to be dissolved. Another way that a contract can be dissolved even if there is nothing wrong with it is if there is a specific law that allows the contract to be dissolved.

Article 367 begins the section by permitting dissolution based on law or agreement:

Article 367  
Cases in Which it is Admitted

1. Contract dissolution based on the law or a covenant is admitted.
2. Any party however who, due to circumstances not ascribable to the other party, cannot return what they have received shall not have the right to dissolve the contract.

Article 368  
Effects Between the Parties

In the absence of special provisions, dissolution is deemed equivalent, as to its effects, to the nullity or annullability of the legal transaction, save the provisions of the following articles.

Article 367 allows contract dissolution if there is a reason for dissolution in the law or in an agreement between the parties. This means that a party can dissolve the contract if there is a

legal reason to dissolve it or if both parties consent, or agree, to cancel the contract. One exception is that a person who is not able to return what they received because of the contract does not have the right to dissolve the contract. This is so that the person is not able to unfairly benefit from a contract and then cancel it because they have to follow through on their obligations. Generally the effects of dissolution are very similar to the ones of nullity or annullability according to Article 368.

An example illustrates the reason for the rule in Article 367(2) that a party who cannot return what they received does not have the right to contract dissolution. For instance, imagine that Bianca wrote an agreement to trade her scooter to Vincent in return for Vincent's radio and 100 US dollars. After they signed the contract, Vincent immediately resold the scooter. He realizes he did not make much money on the scooter, so he tries to get the radio back by requesting to dissolve the contract. Bianca thinks this dissolution would not be fair, because she would not get her scooter back. Since Vincent does not possess the scooter he received in the contract anymore, he does not have the right to dissolve the contract according to Article 367(2). This rule makes sense since the law prefers equal results. Bianca only has to give back what she got from the trade if she also gets back what she gave away in the trade.

#### *Dissolution Applies Retroactively*

Next the Code states that contract dissolution applies retroactively unless the parties do not want it to. Retroactive application means that the dissolution applies to their previous actions and they have to undo the other things that they already did under the contract. An exception to this rule can be found in continuously executed contracts. In these contracts, dissolution will not operate retroactively unless the past performances relate specifically to the reason of dissolution. In that case, all of the past performances of the contract must be dissolved and undone.

#### Article 369 Retroactivity

1. Dissolution has a retroactive effect, unless retroactivity contradicts the will of the parties or the purpose of dissolution.
2. In continuously or periodically executed contracts, dissolution does not cover the considerations already rendered, unless such considerations and the cause for dissolution are linked by a bond that legitimises the dissolution of them all.

Article 370  
Effects with Regard to Third Parties

1. Dissolution, even if expressly agreed upon, does not diminish the rights acquired by third parties.
2. Registering however a dissolution action concerning property or movables subject to registration shall render the right of dissolution opposable to a third party who have not registered their right before the action has been registered.

Dissolution applies to the past performance unless the parties want the dissolution to only apply to the future. Parties may not want to apply the dissolution retroactively if they are happy with their previous exchanges. Similar to nullity, Article 370 also protects the rights of bona fides third parties in the case of dissolution of transactions involving objects subject to registration such as real state and vehicles. If a third party registers its rights before the action seeking dissolution is filed, it is protected against such a dissolution.

Parties can choose to not apply dissolution retroactively under Article 369. For example, imagine a situation where Ramona has many fruit trees and Roberta fishes most days. Because of this they agree to exchange some fruit for fish every week for the next year. If one of them is unable to continue the contract and wants to dissolve, they might prefer to only make the dissolution apply in the future. Since each party already has eaten what they traded, they may not benefit from trying to return what they exchanged in the past. In Article 369, the use of the word “considerations” means the same thing as “performance” in that context.

Continuous Contracts Under Article 369(2)

Article 369 states an exception to retroactive dissolution for continuous contracts. When parties regularly execute, or fulfill, their contract, dissolution only applies to future performance. For continuous contracts, dissolution is not retroactive unless the reasons for dissolution make it make sense to dissolve all of the previous actions.

For example, a long-term government contract with the United Nations for yearly shipments of health supplies like medicine and medical equipment could be an example of a periodically executed contract. If the government or the UN needed to dissolve the contract, they may or may not have a reason to undo the previous performance. If the reason for dissolution is defective supplies, meaning that the supplies don’t work correctly, then the unique circumstances



could justify applying the dissolution to the past. Dissolving past performance would mean reversing the previous exchanges. On the other hand, some reasons for dissolution of a continuous contract do not require applying dissolution to the past. If there is a new reason for dissolution, then the dissolution might apply only to the future performance. A recent supply shortage would be another reason to dissolve the continuous contract because the UN would not have enough supplies to give to the government. Dissolution for a supply shortage would require only dissolving future performance; because there was nothing wrong with the past performance and no reason to undo it. A current supply shortage would not impact or effect past performance. Therefore, the dissolution does not need to be retroactive.

As these examples illustrate, different situations require different approaches to contract dissolution. Parties can seek dissolution based on a law or based on their own agreement to end the contract. Dissolution generally applies retroactively unless the parties prefer otherwise. Like nullity, dissolution concerning transactions involving objects subject to registration generally should not harm the interests of bona fides third parties that have registered their rights before the dissolution action is initiated.

### **7. How does a party dissolve a contract?**

To dissolve a contract, a party should make a declaration to the other party under Article 371. The parties can agree on a deadline for dissolution. If they did not set a deadline, then the party who does not have the right to dissolve the contract can give the other party a reasonable deadline for dissolution.

#### Article 371

#### How and When is Dissolution Materialised

1. A contract can be dissolved by way of declaration made to the other party.
2. If no deadline has been agreed for contract dissolution, the other party may assign to the holder of the dissolution right a reasonable deadline to exercise it, or otherwise forfeit it.

#### *Declaration of Dissolution Under Article 371(1)*

Under the first part of Article 371, a party can cancel the contract by making a declaration to the other party. Additionally, the other party, the one who is not making the

dissolution declaration, to the contract can set a reasonable deadline for dissolution if there is no established deadline in the agreement. The purpose of the declaration is to let the other party to the contract know about the dissolution. The purpose of being able to set a reasonable deadline is so that eventually the party can know that the contract will not be dissolved and he is safe to rely on it without any risk.

Without the requirement of notification, one party could dissolve the contract and stop performing their part of the agreement without notifying the other party. The declaration to the other party gives the parties equal information and notifies the other party to stop completing their contractual duties at the same time. This is important because otherwise one party might lose money by preparing for the fulfillment of the contract that will not be fulfilled. Without the ability of the other party to set a deadline, the party setting the deadline would never know when they were free from the possibility of undoing the contract. If they always think that they might have to undo the contract, even many years into the future, they will be less free to buy and sell other goods and make other contracts with other people because they will always have to worry about being ready and able to undo the old transaction.

A declaration of dissolution can come in written or oral form. A contract between the UN and a non-profit organization, for instance, would be in writing. It is likely that the dissolution would also take place in the form of a written declaration. In contrast, two neighbors might make an oral contract to start a small grocery shop in one of their homes, but if one person later decides to dissolve the contract, it is likely that the declaration of dissolution would also be an oral agreement.

#### *Deadline for Dissolution Under Article 371(2)*

The second part of Article 371 addresses the timing for dissolution. One party may choose a reasonable deadline for the other to dissolve the contract if there is not an agreed upon deadline. The reason for this reasonableness standard is fairness. Parties often rely on their contracts and make plans based on the idea that the contract is final. If one party relies on the contract for years, then it would be unfair to surprise them and disrupt their plans with a sudden dissolution a long time later. The parties can agree in advance on a deadline to avoid this type of uncertainty. Otherwise, one party can set a reasonable deadline during which dissolution by the other party is permitted. It is important that the non-dissolving party can only set a “reasonable”

deadline because it has to be realistically possible for the other party to dissolve the contract if they have the right to. If the other party could set a very short deadline, then the right of the other party to dissolve the contract would be unfairly compromised or weakened, because it would be unfairly difficult for the dissolving party to do dissolve the contract on time.

#### **8. What happens to a contract if the circumstances change significantly?**

If the circumstances on which the parties made their contract change in a significant, or big, way, then the harmed party can dissolve the contract. Alternatively, instead of dissolving the contract, the harmed party can instead modify the contract to make it fair under the new circumstances. This ability to cancel or change the contract does not apply, or is not available to the harmed party, if the harmed party was not following the contract when the circumstances changed. Only if the harmed party was doing what they promised they would do under the contract, and trying to fulfill their promises in good faith, does the ability to cancel or change the contract exist; and even then only if the circumstances change a lot. Articles 372-374 contain the standards for dissolution due to changed circumstances.

Article 372  
Conditions for Admissibility

1. If the circumstances on which the parties based their decision to contract are abnormally changed, the injured party have the right to dissolve the contract, or to modify it in the light of equitable considerations, to the extent that demanding that the obligations undertaken by such party be honoured may seriously harm the principles of good faith and is not covered by the risks inherent in the contract.
2. Once the dissolution has been requested, the contrary party may oppose the request, declaring to accept a modification of the contract according to the foregoing paragraph.

Article 373  
Injured Party in Default

The injured party shall not benefit from the right of contract dissolution or modification if they were in default at the moment in which the circumstances changed.

Article 374  
Arrangements

Once the contract has been dissolved, the provisions of the foregoing subsection shall apply to dissolution.

These articles on changed circumstances can provide an important way to adjust an agreement when there are unexpected changes. Since there are numerous ways that circumstances can change, it is important to differentiate between the changed circumstances that justify contract dissolution or modification and those changed circumstances that do not justify contract dissolution and modification. If courts allowed parties to cancel a contract based on any change in circumstance, then contracts would change too frequently and they would lose their value and reliability. Contracts would become very risky because they would not be very certain, and because they would be risky, people would use them less and would not make as many agreements. Because people being able to make agreements is a very important part of economic development, courts only let people dissolve contracts very rarely when circumstances change a lot.

*Injured Party in Default Under Article 373*

When the harmed party has not been in compliance with the contract, meaning doing their obligations under the contract, then they cannot benefit from a dissolution because of changed circumstances. For example, if one party is behind on their payments when the circumstances change, or has not delivered the goods they promised, they do not have the right to dissolve or modify the contract. The purpose for this exception under Article 373 is to not allow parties in default to benefit from a change in circumstances. This is because we don't want to reward people who are in default. The reason that the principle of changed circumstances exists is to protect parties' interests; but this protection does not apply when the party has not been respecting the agreement itself and their obligations to the other party.

For instance, imagine Angel took out a loan from the bank that required small repayments each month so that she could start a small business selling cell phones from her home. The business did not go well, and not many people bought her phones or calling cards. She stopped making payments back to the bank. Then circumstances changed because there was

a large flood and all of her cell phone and her house were destroyed. We don't actually know for sure that the court would decide that a flood destroying Angel's house and her cell phones is unusual enough that she should be able to dissolve the contract, but they might. It is also possible that the court would decide that the flood is an unusual enough circumstance that Angel will not have to pay back all of the loan but will still have to pay back most of it. Let's pretend for this hypothetical circumstance that the court would decide that the flood was unusual enough that if she were not in default on her loan she would not have to pay back all of the loan money. In this case, her being in default, or not paying back the loan, means that even though the court would normally let her dissolve the contract, in this case they won't. That is because she is not entitled to the changed circumstances protection under Article 372 because Article 373 states that it does not apply to parties in default. Because Angel was in default before the flood, she still owes the bank the entire value of the loan. Since parties in default are not respecting the contract, the Timor-Leste Civil Code does not provide them with the ability to dissolve or modify the contract based on changed circumstances.

## **9. Summary of What We Have Learned**

Thus far, we have learned that the Code provides several ways to nullify, annul, or dissolve a contract. Normally nullity, annulment, and dissolution apply retroactively. Nullity normally happens when a contract violate a provision of the law. Annulment on the other hand comes from several things in the Civil Code including exploitation, illegality, or fault. Fault does not require cancelling the entire contract. To remedy a fault, parties may confirm, annul, reduce, or convert the contract to a better form. Parties also can seek contract dissolution either because of a provision in the contract allowing it, a specific law allowing it, or due to significant changed circumstances. In sum, the Code provides parties with multiple methods for dealing with unforeseen problems or faults in their contract. Each party should assess his or her situation to determine if nullification, annulment, dissolution, reduction, or conversion best fits their situation.

## **10. Relevant Civil Code Articles**

Articles 273-275: Usury and Contracts

Articles 276-282, 285: Rules for Nullity and Annulability

Articles 283-284: Reduction and Conversion

Articles 371-374: Dissolution and Changed Circumstances

## 11. Examples and Discussion Questions

### Example 1

Mr. Castro and Mrs. Magnos come to an agreement that Mrs. Magnos will sell her work horse called Nenny to Mr. Castro. They both believe the horse is a good working animal and will be a good form of transportation around Mr. Castro's farm. Since Nenny has never been pregnant, they both believe she is infertile. To their surprise, Nenny becomes pregnant with a foal after the sale. This makes her much more valuable than if she was infertile and only could be used as a working horse. Mrs. Magnos claims that this new information—that the horse is able to breed—makes the horse more valuable. She requests that Mr. Castro pay her the difference between the original price he paid and the value of a breeding horse. Mrs. Magnos also argues that their mistake justifies annulling the contract and then converting it to a fair agreement. Mr. Castro does not want to change the contract because Nenny is still able to perform the work for which he bought her.

### **Discussion Question**

1. What should the Court do?

### **Answer**

This question is whether or not a mistake regarding the horse's value justifies modifying or annulling the contract. The Court will have to determine whether or not this type of mistake is material to the contract. Mr. Castro received the benefits he wanted from the contract, and he paid Mrs. Magnos for those services. In contrast, Mrs. Magnos feels that the mistake meant that she did not receive a fair payment for the horse. The Court will first need to decide if this mistake is significant enough to annul the contract. Then the Court would need to determine, under Article 284, whether or not the parties would have drafted a different version of the contract if they had anticipated this situation.

## V. TYPES OF CONTRACTS AND SPECIAL RULES FOR FORMING SPECIFIC TYPES OF CONTRACTS

### SECTION OBJECTIVES

- To understand the wide variety of contract types in the Civil Code.
- To learn how to find relevant sections of the Timorese Civil Code when drafting particular types of contracts.

The Timor-Leste Civil Code contains rules for specific types of contracts that do not apply to other contracts. While explaining all of these special rules is too much detail to cover here in a simply introductory textbook, this subsection is meant to show you where to find rules for particular types on contracts in the Timorese Civil Code. Once you know where to look to find these rules, you can find these on your own in the Civil Code whenever you need them. Being able to look these sections up on your own will be important when you are working as a lawyer.

Here is a list of common contracts with special legal rules:

- Promised Contracts, Articles 345-348: Promised Contracts are the ones in which parties oblige themselves to enter into a contract in the future. There is a *bilateral promise* to contract. Think about a house that is under construction; one party declaring she will buy the house once the construction is finished and the other party declaring she will sell the house. The Civil Code articles regulating promised contracts provides special rules regulating the process for the transfer of rights and obligations between parties through promise contracts and the process for setting a deadline for a unilateral promised contract.
- Preference Pacts, Articles 349-358: Preference pacts are covenants, or agreements, in which a person agrees to give the first option to someone in the sale of an item. That means that person that the seller promised will have the first chance to buy a particular item has a legal right to have the first chance to buy the item before anyone else. If the owner of the named item wants to sell the item, she must tell the preferred party so that the preferred party can decide whether or not to exercise their preferred status, meaning to decide whether or not to buy the item before anyone else can. The Civil Code

articles regulating preference pacts talk about the sale of the property, the process for transferring the preferred status, and the value of the preference.

- Unilateral Transactions, Articles 392-398: Unilateral promises or transactions are similar to promised contracts but the promise comes from only one of the parties. In these cases, a promise is only binding under the special circumstances described in Civil Code Articles 392-398. These articles explain the process for forming unilateral promises, making promises in public, and revoking promises.
- Contracts Benefiting Third-Parties, Articles 378-386: Contracts benefiting third-parties are contracts made to benefit people who are not a party to the contract. The Civil Code articles regulating contracts benefiting third-parties describe the rights of the third party and the performing party, as well as what to do when the third-party beneficiary either agrees to or rejects the agreement.
- Mortgages: Mortgages are contracts that give a real property as a guarantee for the non-performance of some transaction. Articles 638-666: Civil Code Articles 638-666 address several types of mortgages, including statutory mortgages, voluntary mortgages, and judicial mortgages. In addition, they contain rules for reducing, transferring, and extinguishing contracts
- Purchase and Sale Contracts are also subject to a specific set of rules laid out in Articles 808-838: Civil Code Articles 808-838 explain price determination, sale, delivery, and payment for an item in a purchase and sale contract.
- Gifts, Articles 874-910: Civil Code Articles 874-910 cover the process for giving gifts, the capacity and ability to give and receive gifts, and many other gift-related topics like the revocation, or taking back, of a gift and being able to continue using an object that has been given as a gift after it has been given.
- Company, Articles 911-952: The basic rules for corporate law and business organizations are found in Civil Code Articles 911-952, in addition to more of these laws which are found in the Commercial Code. These articles govern the formation of corporate agreements and partnerships. Other topics covered in these articles include corporate management, distributions of profits and losses, corporate representation, dissolution, and liquidation.



- Leasing, Articles 953-1040: Leasing contracts are agreements where one party pays the other in exchange for the use of an asset, such as real property, for example. Leasing contracts are governed by many special rules that apply only to leasing contracts. Among the features of leasing contracts that are regulated in this section of the Civil Code are the obligations of the lessor and the lessee, the cost of the leased object, and the process for renting property.
- Livestock Lease, Articles 1041-1048: Civil Code Articles 1041-1048 explain a few special rules for livestock leases. These articles also describe the obligations of lessee and rules for using the animals during the lease. In addition, Article 1047 assigns the majority of the risk in a livestock lease to the lessor, as long as the problem is not attributable to the lessee.
- Loan, Articles 1049-1061: Special rules for loans can be found in Articles 1049-1061 of the Civil Code.
- Employment Contracts, Articles 1072-1073: Employment contracts govern both physical and intellectual work that is done in a job. In addition to Civil Code Articles 1072-1073, employment contracts are governed by special legislation. Therefore, if you need to make an employment contract, you should first ensure that both the legal requirements contained in the Civil Code and in any other relevant special legislation have all been met.

## CHAPTER 3: PERFORMANCE

### CHAPTER OBJECTIVES

- To understand the process for contract performance under the Timor-Leste Civil Code.
- To explore the location and timeframe requirements for performance.
- To be familiar with third party performance.
- To understand both debtors' and creditors' rights in performance.

### I. OVERVIEW OF CONTRACT PERFORMANCE

Contract performance is the fulfillment of contract obligations. The purpose of this chapter is to explain the meaning of contract performance and to identify who can do the performance. This chapter will also explain the location and timeframe for contract performance. The most fundamental rule for contract performance is that the parties always must act in good faith, as stated in Article 696 of the Timor-Leste Civil Code.

It is first important to clarify the terms “debtor” and “creditor” that will be used a lot in this chapter. These terms are normally used when talking about loans. In the case of a loan, the person who loans their money to someone, and who that person must pay money back to, is called a creditor. Also in the case of a loan, the person who has money lent to them that they must later pay back, is called a debtor. The terms when we are taking about contracts have a meaning that is a little bit similar but not completely the same. In a contract, someone who owes a duty or responsibility is called a debtor, and someone who has a duty or responsibility owed to them, is called a creditor. It is like with a loan because a debtor owes the creditor the loan money back, and the creditor has the loan money owed to him. In contracts, it is often the case that both parties are both debtors and creditors to one another. For example, imagine that two people agree that they will trade a horse for a motorcycle. In this case, the person who owns the horse is a debtor because he now owes the man who owns the motorcycle a horse that he must give him, but he is also a creditor because the man who owns the motorcycle owes him the motorcycle and must give it to him. The same thing is true with the other man who originally owned the motorcycle; he is a debtor because he owes the other man his motorcycle, and a creditor because the other man must give him his horse, which he now owes him.

It is important to understand how to fulfill a contract entirely so that you can advise your clients on the correct way to complete the contract. Most rules have a “default” rule which is the way that the law wants the contract to be done unless there is a good reason, or an agreement between the parties, to do it differently. This means that while not all contracts have to be done the default way, they often should be.

Here is an example of some of these default rules:

- Most contract obligations should be fulfilled completely at one time, not in parts.
- The creditor has a right to demand performance, or what he is owed, at any time and it should be given to him.
- The debtor can give performance at any time and it should be accepted.
- The performance location should be the domicile of the debtor, meaning where the debtor lives, except for with financial contracts, where the default location of performance is the creditor’s domicile, where the creditor lives.
- For movable assets, performance should take place at the location of the asset at the time of contracting.
- A third party may perform on behalf of the debtor unless (1) the substitution adversely affects the creditor, meaning that not having the original debtor do the work is less good for the creditor or (2) the creditor refuses and the debtor also objects to the substitution.

When you are advising on contract performance it is important to remember to consider the default laws on timing, location, and substitution. If these are not good for your client or they would prefer different options, it is your job as a lawyer to include in the written contract different rules that change these default rules.

As background for our discussion on contract performance, Article 341 discusses the basic principle that parties should comply with contracts on time. Furthermore, changing or ending the contract generally requires all parties to agree unless nullification, annulment, or dissolution are possible for the reasons discussed earlier.

Article 341  
Effectiveness of Contracts

1. Contracts should be timely complied with and may only be modified or extinguished by mutual consent of the parties, or in the cases admitted by law.
2. Contracts only produce effects regarding third parties in those cases and terms specifically established by law.

**1. Must a debtor fulfill the contract completely or can they do it in parts?**

Article 696  
General Principle

1. The debtor fulfils the obligation when he or she renders the performance to which it is tied.
2. In fulfilling the obligation, as in exercising the corresponding right, the parties must act in good faith.

Article 697  
Rendering a Consideration in Full

1. The consideration shall be rendered in full and not in parts, except as otherwise agreed or determined by law or by local custom.
2. The creditor is entitled, however, to demand a part of the consideration; demanding such part does not mean the debtor may not offer the full consideration.

In Article 697 the term “consideration” means the same thing as performance. It means doing the things or giving the objects that the party is obligated to give under the promises they made in the contract. A debtor generally must fulfill the contract all at once. According to Timor-Leste Civil Code Article 697, there are three exceptions to this rule when: (1) the law says otherwise, (2) the contract permits fulfillment in stages, and (3) when local custom supports contract fulfillment in stages. This means that if the law allows the debtor to fulfill their obligations not all at once or when it is customary to not fulfill the duties not all at once, than the debtor doesn’t have to. The debtor can also not fulfill their obligations all at once if it was included in the contract that they do not have to. While the general rule requires performance in full, it is also okay for a creditor to request partial performance. However, if the creditor requests only partial performance, the debtor is still allowed to do the full performance if they want to.

The purpose of a rule of full performance is to ensure that the agreements of the contract are fulfilled in a quick and complete way. This rule is good for the creditor. Because this is a rule that is supposed to benefit the creditor, the creditor is allowed to not use it completely and to allow the debtor to start off with only partial performance. Demanding partial performance does not mean that the debtor is free from the obligation to fulfil the contract, it only means that they have more time to complete it.

As the default rule, the creditor does not have to accept anything except full performance of the debtor's duties and obligations. For example, if a businessperson needs a delivery of magazines to sell at an event, and the delivery is late or only half the order arrives, then the delivery of magazines is inadequate to help the businessperson meet their goals of increasing sales at the event. Thus, Article 697 protects the businessperson from having to allow partial performance when it does not meet the contract obligations.

At the same time, the exceptions in Article 697 are designed to allow flexibility. Parties to a contract can design the timing of performance in any way they want if they include it in the contract. The default is full performance, not performance in parts, but if the circumstances are better-suited for performance in parts, the parties can allow it by putting it that way in the contract.

In drafting a contract, parties should think about what other time and resource limitations and constraints they have during contract performance. Then they can decide whether performance in full or performance in parts is a better fit for their situation. Some reasons for performance in parts might be, for example, when a builder only has the supplies for part of the project at one time and has to wait for more. Another reason is if a builder will need to take a break during the rainy season because the weather will make it difficult to build, and so will have to build the building in two sessions instead of all at once. In addition, if the local practice in a particular industry is for performance in part, then that custom of partial performance is permitted.

## **2. Who may render and receive consideration, or performance?**

Article 698  
Competence of Debtor and Creditor

1. A debtor has to be competent, if the consideration constitutes an act of disposal of an asset; but a creditor who has received something from an incompetent debtor may oppose the request for annulment if the debtor has not incurred any loss through the consideration.
2. The creditor must, for his or her part, be competent to receive the consideration; but, if the latter comes into the power of the incompetent person's legal representative or his or her estate is augmented, the debtor may oppose the request for annulment of the consideration rendered and renewed fulfilment of the obligation, insofar as it has been received by the representative or through enrichment of the incompetent person.

Sub-Section II of the Timor-Leste Civil Code describes who may give and receive consideration. Consideration here means performance, or more generally it means those obligations which a party has promised to fulfil as part of the contract. Giving consideration is often called “rendering” consideration when discussing contract law.

As a general rule, debtors and creditors must have legal capacity for performing their respective obligations. This is to protect the assets of incapable persons and their respective rights. Remember the rules for entering into contracts regarding legal capacity in Chapter 2. If a debtor who does not have legal capacity gives consideration (performs any obligation) and such a consideration involves an act of disposal of assets, the creditor may only prevent the transaction from being annulled if the act of disposal has not harmed debtor. Similarly, the creditor also must have legal capacity. If the creditor who does not have legal capacity benefits from the transaction, then the debtor may not oppose the request for annulment. This is to be fair, because the performance has not harmed the incapable person and can be therefore considered valid.

The purpose of the first part of Article 698 is to prevent creditors from taking advantage of incapable debtors. For example, a creditor should not accept performance from a debtor who is underage or under the influence of alcohol or anytime the debtor is not fully aware of his or her actions. An incapable debtor is unable to make responsible decisions and think through the impacts of their actions. In addition, the second part of the Article protects the interests of incapable creditors. Protecting creditors is useful because, if a creditor is temporarily incapable, then they might not notice if performance is incomplete. When debtors render performance, they

should make sure the creditor is competent and able to accept the fulfilment of the debtors part of the contract in a responsible way, and that they understand what is going on.

#### Article 701

##### Persons Who May Render Performance

1. Consideration may be rendered either by the debtor or by a third party, who may have an interest in the fulfilment of the obligation or not.
2. The creditor may not, however, be forced to accept consideration from a third party, when it has been expressly agreed that the consideration should be rendered by the debtor, or when the substitution adversely affects him or her.

#### Article 702

##### Refusal of Consideration by the Creditor

1. When the consideration can be rendered by a third party, the creditor that refuses it falls into default vis-à-vis the debtor.
2. It is, however, licit for the creditor to refuse it, provided the debtor is opposed to fulfilment and it cannot be sub-rogated to the third party pursuant to Article 527; the debtor's opposition is not an obstacle to the creditor validly accepting the consideration.

A third party, meaning another person different from who was originally supposed to fulfil the contract, may fulfil the obligations of the contract unless the contract specifically states that the original party must fulfil the contract by himself. That means that the creditor cannot be forced to accept the performance of a third party when the parties to the contract agreed that the debtor would be the one to complete performance. Also, even if the parties didn't agree in the contract that the debtor would be the only one to perform the contract, if the replacement of the debtor by the third party would hurt the creditor in some way, then Article 701 would also prohibit third party performance in that case. This is because it is not fair for the debtor to be able to get out of doing what he said he was going to do by having someone else do it for him is someone else doing it for him hurts the person he made his promise to. For example, if the debtor made a contract with the creditor to paint the creditor's house but then instead has a third party do it, that is probably fine. That is because, if you remember from our earlier discussion of the objects of contracts, house painting is a relatively fungible, or substitutable object. One person painting a house is the same as another person painting the house. But if the debtor made a contract with the creditor to paint a portrait of the creditor's family, then the creditor would be

harmful by the debtor not doing it and instead finding someone else to do it. That is because paintings and artistic talent are very unique and not very fungible. The creditor paid the debtor to make the painting because he liked the debtor's unique skill, and so it is not the same thing to have another person with a different skill do it instead. In the case of painting the house, the court would allow a third party to substitute for the debtor, but in the painting of the portrait of the family, the court would not allow the substitution.

Article 701 gives the debtor the option to find a replacement to render performance if necessary, but it also protects the creditor's interests by not allowing this replacement if it would harm the creditor. Article 702 also requires the creditor to accept third party performance as long as the performance is not harmful to him. If the creditor refuses to accept performance from a third party when it is not harmful to him, then not accepting this performance puts the creditor in default with the debtor.

The debtor may refuse to accept third party performance in case the third party cannot be subject to the terms of Article 527 (sub-rogation). In this case, the non-performance of the debtor does not prevent the creditor from accepting performance of the third party.

#### Article 703

#### To Whom Performance Must be Rendered

The consideration shall be rendered to the creditor or his or her representative.

#### Article 704

#### Consideration Rendered to a Third Party

Consideration rendered to a third party does not extinguish the obligation, except:

- If it was thus stipulated or consented to by the creditor;
- If the creditor ratifies it;
- If the one who received it had later acquired the credit;
- If the creditor should benefit from the fulfilment and not have a justified interest in not considering it as having been rendered to himself or herself;
- If the creditor is the heir of the one who received it and is liable for the obligations of the one he or she succeeds;
- In the other cases where the law so determines.

Article 703 addresses who must receive the contract performance for the completion of the contract to be valid. This article simply states that the performance must be rendered, or



given to, to the creditor or a representative of the creditor. Fulfilling the contract for a third party does not release the debtor from her obligation unless the situation meets one of the exceptions in Article 704. The exceptions are:

- (1) If the parties agreed to the third party receiving the performance in the contract.
- (2) If the creditor approves of the change.
- (3) If the receiver had later received the credit, meaning the right to receive the performance.
- (4) If the creditor will benefit from this performance to the third party and has no reason to object.

There is a variety of circumstances when a debtor may have reason to render performance to a third party. If the debtor cannot locate the creditor, it may be necessary to render performance to a third party. In addition, if the contract is meant to benefit the third party, then it could be more efficient and make more sense in certain circumstances to render performance directly to the third party it was meant to benefit. For example, if a father bought a motorcycle for his daughter who lives in a different city, it might make sense for the debtor to deliver the motorcycle directly to the daughter instead of delivering it to the father first to deliver it to the daughter. Another common case is if the creditor passed away it will likely make the most sense for a debtor to render performance to the heirs of the creditor's estate. For example, if the owner of Victor's Music Stand dies but the will transferred the ownership of the music stand to his wife, then it would make sense for Mariano to bring the deliveries to the music stand's new owner.

To avoid tricky issues of who the debtor should deliver performance to when it is not clear, it is always a good idea as an attorney to include this clearly in the original contract.

### **3. Where should performance usually take place? Are there different location requirements for different types of performance?**

Article 706  
General Principle

1. In the absence of a stipulation or special provision in law, the consideration shall be rendered in the place where the debtor is domiciled.
2. If the debtor changes domicile after the obligation is constituted, the performance shall be rendered at the new domicile, except if the change entails a loss to the creditor, and in that case shall be rendered at the original place of domicile.

Article 707  
Delivery of a Chattel

1. If the consideration has as its object a particular movable asset, the obligation must be fulfilled at the place where the thing was located at the time the deal was closed.
2. The provision set out in the preceding paragraph is still applicable in the case of a generic thing that must be chosen from a given set of things or a thing that must be produced in a certain place.

Article 708  
Pecuniary Obligations

If the obligation has as its object a certain sum of money, the consideration shall be rendered where the creditor is domiciled at the time of fulfilment.

Article 710  
Impossibility of Consideration in the Stipulated Place

When consideration is or becomes impossible at the place stipulated for fulfilment and there are no grounds for considering the obligation null and void or extinguished, the additional rules in Articles 706 to 708 are applicable.

The Timor-Leste Civil Code addresses the location for performance to take place in Article 706. The default location for performance is the debtor's home, unless a special provision in law states it should take place somewhere else or the parties agree that it should take place somewhere else. If the debtor moves, the new home will be the new performance location unless the change to the new location is bad for the creditor. If it is bad for the creditor, the location should be the original house at the time of the contract or somewhere else that both parties agree on. If circumstances change so that the location for performance that the parties had previously agreed upon can't be used, such as if there is a fire or a flood, then the parties should refer to Articles 706 and 708 and use the default places set out in those articles. If the performance is an

exchange involving money, then the exchange should take place at the creditor's home. If a contract involves a movable asset, then the contractor should follow Article 707. This provision directs contracting parties to render performance at the place where the movable asset was located at the time of contracting.

There could be several purposes of designating a general location for performance. First, having a default location promotes clarity. Then if the parties forgot to designate a different location when making the contract, the default rule avoids misunderstandings. For most types of performance, the person can render performance at his or her own home. While for financial transactions, the performance should be at the creditor's home.

In sum, the Timor-Leste Civil Code provides options for the parties to choose their own performance location but provides a default in case they do not specify. In addition, Article 710, regarding impossibility, allows a party to change the location if the original location is not longer feasible. This article allows a small change of the default rule as a way to avoid complete elimination of the contract.

Imagine that Mariano gets CDs shipped in from Indonesia and sells them to smaller CD sellers all over Dili. Victor owns a Music Stand where he sells CDs and he makes a contract with Mariano that Victor will come pick up CDs from Mariano at Mariano's house each Friday. If Mariano moves his family and his CD stock to another part of town, then it might make sense for Victor to pick up the CDs at Mariano's new home. What happens, though, if Mariano's new home is much further from Victor's Music Stand than his old home was? Is it fair for Victor to have to go further every week to pick up the delivery? Under Article 706, if Victor can show that the new location is harmful to his interests, for example because it takes too much time to walk there or too much money to pay for a ride there, then either Victor and Mariano will have to agree to a different location or they will have to return to using the original location; Mariano's old house.

If the parties to a contract prefer a performance location different from the default rule, then the debtor and the creditor should agree to a different location in advance. When drafting a contract, parties should think about the supplies, space, and planning needed for performance. These factors will affect the parties' decision on where to render performance.

#### 4. What is the timeframe for contract performance?

Articles 711-716 address the timing of contract fulfillment. Unless the contract, or a legal rule, gives a specific time for the performance, the creditor can request fulfillment at any time and the debtor can fulfill the contract obligation at any time. If it is necessary for there to be a specific timeframe for performance, then the parties should try to agree on a possible timeframe in advance and put it in the contract. If the parties are unable to agree on a date, but a timeframe is necessary, then the Courts should facilitate the determination of the timeframe.

##### Article 711

##### Determination of the Timeframe

1. In the absence of a special stipulation or a provision in law, the creditor has the right at all times to demand fulfillment of the obligation, just as the debtor may at all times exonerate him or her from it.
2. If, however, it becomes necessary to establish a timeframe, whether due to the very nature of the consideration, due to the circumstances that have determined it, or due to local custom, and the parties are unable to agree on setting it, its establishment is referred to the Courts.
3. If the establishment of the timeframe is left up to the creditor and he or she does not use the right granted him or her, it is the responsibility of the Court to set the timeframe, at the debtor's request.

The purpose of Article 711 is to establish a default rule, which is that the creditor can request the performance at any time. Similarly, the debtor may render performance at any time. Part Two of this provision also provides a judicial solution if the parties cannot agree on a timeframe. Then Part Three explains that, if the creditor has the right to establish the timeframe, such as if that right was given to him in the contract, and does not do so, then the debtor can request that the Court establish the timeframe.

Article 711 exists because timing can be very important and can affect a debtor's ability to fulfill contractual duties. This is why parties should think about timing while making the contract and writing it down, instead of waiting until later. When drafting a contract, parties should discuss when each party needs the other party's performance to be rendered as well as the discussing all of the things that will need to happen before they can render performance.

For example, think about two parties discussing a contract for construction of a house. The builder, Valentino, should think about all of the tools and supplies he needs as well as how

long it will take him to get them. He also might want to think about how many extra people he needs to hire to help him build. The buyer Gloria should think about when she wants to move into the house. To avoid future problems, timing should take into consideration both parties' needs and should be discussed before being included in the contract.

Article 713

Beneficiary of the Timeframe

The timeframe is understood to be established in the debtor's favour when it cannot be shown that it was in the creditor's favour, or in favour of the debtor and the creditor jointly.

Article 714

Loss of the Benefit of the Timeframe

1. Once the timeframe has been established in the debtor's favour, the creditor may, nevertheless, demand immediate performance of the obligation if the debtor becomes insolvent, even if the insolvency has not been declared judicially, or if for some reason attributable to the debtor the guarantees for the credit are reduced or if the promised guarantees are not provided.
2. Instead of immediate fulfilment of the obligation, the creditor has the right to demand the replacement or reinforcement of the guarantees from the debtor, in the event the latter suffer reduction.

Article 713 is another default rule. It states that the debtor should be the beneficiary of the timeframe if the contract did not designate the creditor as the beneficiary or the debtor and creditor jointly as beneficiaries of the timeframe. The idea is that as a default rule the debtor should be able to benefit from having as much time as he needs unless there is a reason to think that the timeframe was supposed to be more beneficial to the creditor or to the creditor and the debtor more equally. Why do you think the debtor is the beneficiary as the default rule? It might be because the debtor already bears the burden to fulfil the contract, so the Parliament wanted to make fulfilment as easy as possible.

If the creditor has reason to believe that the contract is not very secure, because the debtor might go into bankruptcy, Article 714 tells us that the debtor may then lose his status as beneficiary of the timeframe. This is done to protect the creditor from the risk that the debtor will be unable to fulfill his duties if he waits too long. In the same situation, if the debtor has lost all of his money or there is another reason that the contract is more risky for the creditor, then the creditor could either request immediate performance or require some type of assurance that the

contract is reliable. For example, if the debtor loses all of his money and goes bankrupt either officially or unofficially, then the creditor may request immediate performance of the debtor's responsibilities. The reason for this is so that there is a greater chance that the debtor will follow through on his responsibilities to the creditor before he loses his ability to fulfill any of his obligations. This rule exists to provide some security to creditors, even though the default rule is that debtors are the beneficiaries of the timeframe. The Timor-Leste Civil Code favours secure contracts to enable creditors and debtors to achieve their goals as far as possible using contracts that they can mostly trust. To help make contracts more trustworthy, the law tries to minimize the risks of problems or surprises.

Article 715

Debt that Can Be Settled in Instalments

If the obligation can be settled in two or more instalments, the failure to perform one of them causes all of the instalments to become due.

Article 715 says that if a debtor fails to pay one instalment of the performance, then the other instalments become due. This serves to discourage debtors from fulfilling their portions of the contract late by making the consequences really serious.

Article 705

Opposition to the Recommendation Made by the Creditor

The debtor is not obliged to render consideration to the creditor's voluntary representative nor to the person authorized by the latter to receive it, if there is no agreement in that respect.

The debtor may render performance to the creditor's representative. If the debtor does not want to render performance to the creditor's representative, however, he is not required to, so long as the parties had not agreed to this in advance. Article 705 encourages the creditor to be clear to the debtor about expectations so that the creditor can have the debtor perform to the party he wants him to perform to. An example of this would be if a debtor agrees to sell the creditor his motorcycle. If the creditor then tells the debtor to sell the motorcycle to a different

person, the debtor can refuse and can require the creditor to take the motorcycle as they originally agreed.

Why would a debtor oppose rendering consideration to the creditor's representative? Maybe the debtor is uncertain if the representative is a valid representative because he didn't have confirmation from the creditor. The debtor would want to make sure that the creditor receives the consideration so there are no misunderstandings. For example, imagine a debtor was once again supposed to give his motorcycle to the creditor as part of a contract selling the creditor the motorcycle. If a representative the debtor doesn't know shows up at the debtor's house and asks for the motorcycle as a representative of the creditor, the debtor may not want to give it to him in case it is a trick and the person is trying to steal his motorcycle.

As another example, remember that Gloria hired Valentino to build her house. Throughout the construction, Gloria, as a party to the contract, pays Valentino. Her boyfriend Gabriel often comes to the meetings too, but he is not a party to the contract. Then, when the home is near completion, Gabriel meets with Valentino and says Gloria asked him to make the final payment and pick up the keys as Gloria's representative. Should Valentino let Gabriel act as Gloria's representative? Remember that Article 705 permits a debtor to refuse to render performance for the creditor's legal representative if that was not already agreed upon between the debtor and creditor. Here, if Valentino distrusts Gabriel's motivations, then Valentino should not give Gabriel the keys. If Valentino knew that Gloria allowed Gabriel to act as her representative, then the exchange would be appropriate. Remember that according to the rules of representation, Valentino may also require that Gabriel provide him with documentation as an evidence he is lawfully representing Gloria on this matter.

Article 717  
Designation by the Debtor

1. If the debtor, in relation to various debts of the same type to the same creditor, renders consideration that does not completely extinguish all of them, it is left to his or her discretion to designate to which debts the consideration refers.
2. The debtor, however, may not make a designation contrary to the creditor's wishes for a debt that has not yet fallen due, if the timeframe has been established in the creditor's favour; and also, it is not licit for him or her to designate, contrary to the creditor's wishes, a debt in an amount greater than that of the consideration rendered, provided the creditor has the right to refuse partial consideration.

Article 718  
Additional Rules

1. If the debtor does not make the designation, fulfilment must be attributed to the debt that is past-due; among various past-due debts, the one that offers the least guarantee to the creditor; among various equally guaranteed debts, the one that is most onerous to the debtor; among various equally onerous debts, the one that fell due first; if several fell due simultaneously, on the one bearing the earliest date.
2. If it is not possible to apply the rules set out in the paragraph above, the consideration shall be deemed to have been done in relation to all the debts, distributed equally, even though with prejudice, in this case, to the provisions of Article 697.

Article 719  
Debts that Entail Interest, Expenses and Indemnification

1. When, besides the capital, the debtor is obliged to pay expenses or interest, or to indemnify the creditor as a result of past-due payment, consideration that does not cover all that is owed is presumed to be rendered in relation to, successively, the expenses, the indemnification, the interest, and the principal.
2. Assignment to the principal can only be done in last place, except if the creditor agrees that it may come before.

The purpose of these articles is to enable the debtor to manage his debts as long as it does not disadvantage the creditor and to set rules for managing the debts that have not been paid yet. Sometimes a debtor may not pay his obligations in full so these articles set criteria for determining which debts will be considered paid and which may be considered unpaid after a partial payment of the obligation.

The idea is that since the creditor took a risk lending the debtor money, he should have that risk minimized as much as possible. Another purpose is to have a clear way to pay different debt payments when there are many of them and it was not decided in advance which debts would be paid with which payments. Having a rule and clear expectations will prevent misunderstandings and save time.

Article 720  
Presumption of Fulfilment

1. If the creditor gives release on the principal without restrictions in relation to interest or other incidentals, the interest or incidentals are deemed to have been paid.



2. If interest or other periodic instalments are owed and the creditor gives release without restrictions for one of these instalments, the previous instalments are deemed to have been satisfied.

3. The voluntary delivery by the creditor to the debtor of the original credit instrument is grounds for assuming release of the debtor and his or her co-debtors, whether joint-and-several or joint, as well as the guarantor and the main debtor, if the instrument is delivered to one of the latter.

Article 721  
Right to Release

1. One who fulfils the obligation has the right to demand release from the one to whom consideration was rendered, such release consisting of an authentic document or one that is authenticated or bears a notary's certification, if the one fulfilling the obligation has a legitimate interest in this regard.

2. The one doing the fulfilment may refuse to render consideration until release is given, and may also demand release after fulfilment.

Articles 720-721 explain the process for releasing the debtor from the contract. For example, if the debtor pays the debt and the creditor releases the debtor, then the court will assume that it means that the contract was completely fulfilled and all small costs and interests have been paid. Under Article 721, once the debtor has completed the obligation, they have the right to demand release from the contract. The creditor then should provide a document to confirm that the debtor is released from their obligations.

Articles 720-721 serve to protect the debtor from being improperly bound by the contract once they should be free from it. It is necessary and fair that the debtor should be free from their obligations once they have either paid the creditor or rendered performance to the creditor. The point of having the release document is so that the debtor can prove that they are no longer in debt, something that might be important for some legal reasons. The other point of having this release is that it shows that the contract is finished and the debtor does not owe the creditor anything. This proof is good to have in case creditor tries to sue the debtor.

Imagine that Carlos and Marcos make an agreement that Marcos will be the distributor for Carlos's coffee business for one year. As the distributor, Marcos will be in charge of distributing bags of coffee beans to shops throughout Dili for the year. Marcos will receive partial payment each month and then a larger sum after completion in one year. What if Carlos paid the monthly payments regularly, but then refuses to pay the final sum after Marcos finished his part of the deal? Article 721 establishes that Marcos has a right to be released from the

contract upon performance. Marcos already rendered performance. Now what does Carlos need to do? Carlos should pay the final amount. If Marcos demands his release, then Carlos should formally release Marcos with a document stating that Marcos has rendered performance. Here, Article 721 gives Marcos instructions on how to obtain confirmation of release from the contract.

Alternatively, imagine that Marcos finished all the deliveries for the year and Carlos promptly paid Marcos the final sum. Then a month and a half later, Carlos comes back saying that Marcos failed to make one delivery and that Marcos needs to bring one more delivery to make up for the mistake. Since Carlos already acted as if the contract was completed, he cannot come back and try to make Marcos do one more delivery under the contract. What should Marcos do if Carlos pressures him to make another delivery—threatening that he will go to the court and sue Marcos? In that case, Marcos should use Article 720. Marcos could explain that Article 720 protects him from subsequent claims after being released from the contract.

The situation could be more complicated. Let's say that Marcos finishes eight months worth of deliveries and then gets injured. Carlos is sympathetic, and he tells Marcos to skip one month of deliveries and just finish up the last three months after that. Business was slow that month anyway, so Carlos did not mind giving Marcos a break. Carlos pays Marcos at the end and releases the contract. A few months later, Carlos gets into tough financial troubles. Because he is desperate, Carlos tells Marcos that Marcos owes Carlos and that he needs to make more deliveries since he gave Marco a month to recover from his injuries earlier that year. Again, Marcos can rely on Article 720. Once a creditor has released the debtor, the creditor cannot claim the debtor is still bound by the contract. This means that he cannot make Marco work for him anymore. Once the contract is over, Marco is free from the contract forever. This rule makes sense; if this rule did not exist creditors could create great uncertainty for debtors by being able to make them work under the contract again once the debtors thought the contract was all over. Article 720 prevents creditors from releasing debtors and then trying to “capture” them again by claiming that the debtor has not completed their obligations.

#### Article 722

#### Return of the Instrument. Mention of Fulfilment

1. Once the debt has been extinguished, the debtor has the right to demand the return of the instrument that created the obligation; if fulfilment is partial, or if the instrument grants the creditor other rights, or if the creditor has a legitimate interest in retaining it for another reason,

the debtor may demand that the creditor include a notation in the instrument of the fulfilment rendered.

2. A third party that fulfils the obligation, having been sub-rogated with the creditor's rights, enjoys the same rights.

3. The provisions of the previous Article, paragraph 2, are applicable to the return of the instrument and the notation of fulfilment.

#### Article 723

#### Impossibility of Return or of Notation

If the creditor claims it is impossible for any reason to return the instrument or make a notation of the fulfilment on it, the debtor may demand release set out in an authentic document or one that is authenticated or bears a notary's certification, with the respective expenses being borne by the creditor.

According to Article 722, upon fulfilment, the debtor has the right to request return of the contract. Upon partial fulfilment, the debtor has the right to request that the creditor document the partial fulfilment in the legal document. The same rule applies if a third party rendered the performance on behalf of the debtor. If the original legal document is not available, then the creditor should put the information in another legal document that they have to pay for.

What do you think is the purpose of giving the debtor a right to demand that the creditor write down even partial performance in the contract? Documenting the partial performance that was completed prevents a creditor from claiming that the debtor owes more than he or she actually owes the creditor. This is just another way of making sure that the debtor is able to prove to the court that they are no longer bound by the contract because they have completed their obligations. If the creditor loses the contract the debtor may demand documentation from the creditor under Article 723 and the creditor has to pay for it.

### **5. Who bears the risk when performance entails a transfer of property?**

#### Article 730

#### Risk

1. In agreements that involve the transfer of title to a certain thing or that establish or transfer an in rem right over it, the perishment or deterioration of the thing due to a cause not attributable to the seller is borne by the buyer.

2. If, however, the thing continues in the possession of the seller as a result of a term established in his or her favour, the risk is only transferred when the term expires or upon delivery of the thing, without prejudice to the provisions of Article 741.
3. When the agreement is dependent upon a resolutive condition, the risk of perishment while the condition persists is borne by the buyer, if the thing has been delivered to him or her; when the condition is suspensive, the risk is borne by the seller while the condition persists.

For transfers or other types of deliveries, it is important to know who has the risk of something going wrong in the middle of the performance. For example, who loses money if goods deteriorate or get lost in the delivery? Under Article 730, the buyer is responsible for any problems during the transfer of property unless the seller specifically caused the problem. Thus, if something goes during the transfer, even if it is through no fault of the buyer or seller, then the buyer should fix the problem. There is an exception to this in contracts where the seller keeps the item until a condition is met. In these kinds of contracts the seller bears the risk while they possess the item and until the fulfillment of the condition results in the transfer to the buyer according to the contract.

Do you think that it makes sense for the buyer to bear the risk while any goods are in travel? According to Article 730, the buyer will be responsible for losses during transfer unless the seller somehow caused the loss. The reason for this rule is that the buyer knows where she wants the new item and likely knows how best to transfer the item. Because of this it makes sense for the buyer to be in charge of transferring the item.

## **II. CONCLUSION**

We have learned that parties entering contracts should think through the details of performance early while they are still writing the contract. Parties entering into contracts and lawyers helping them should refer to Chapter VII, Section I on Fulfilment when they are planning contract performance. When drafting a contract, contractors should consider the best location, timeframe, and back-up plan in case there is a change in one of the parties' situations. It is also important to consider who can render and receive performance on behalf of the debtor and creditor. The Timor-Leste Civil Code contains many default rules, but if these rules do not fit one's circumstances, then the parties and their lawyers can, and should, draft around these rules.

### III. EXAMPLES AND DISCUSSION QUESTIONS

#### *Example 1*

After his boat gets broken by a large wave crashing it into a sharp rock, Sergio decides he needs a new fishing boat. Since he spends every day on the water, he wants to make sure he gets a good one that won't break down or sink and leave him out in the water far from shore. After talking to all his neighbours for advice, he learns that Claudio is the best boat builder in town. Claudio's services cost more, but everyone says Claudio's expertise is worth the extra money. Sergio and Claudio agree that Sergio will pay Claudio 2,000 US dollars in six months for a new boat. Four months later, Claudio realizes he is behind schedule and will not be able to finish the boat in time if he does not speed up. In order to try to meet the deadline, he hires another boat-builder to build the remaining two-thirds of the boat. Upon delivery, Sergio learns that Claudio only built the hull, while another builder did most of the rigging and outer work on the boat. Sergio refuses to pay for the boat.

#### **Discussion Questions**

Is he entitled to refuse the boat because the work was done by a third party, or is Sergio legally obligated to accept the boat?

#### **Answers**

Under Article 701, if the parties specifically agreed who would render performance, then the creditor, Sergio, would be entitled to refuse performance by a third party. However, if their contract was not specific and did not specify who had to build the boat then it would be up to the court to decide if he was required to accept the boat. Sergio could argue to the court that even if the contract did not require that a specific person render performance the third party substitution negatively affected him. He would argue that he paid a extra money for his boat specifically because he wanted Claudio to build it, since he is an especially good boat-builder. He will want the court to know that the boat is not very fungible but instead is unique and that having one person build the boat is not the same as having another person build the boat, and that they have different values. He will say that because of this difference in value, having a third party build the boat adversely affected him, meaning it affected him in a negative, or bad, way.

Example 2

Imagine that Franco agrees to sell and deliver a portion of his crops, including bananas, cashews, and oranges, to Bahia Market. As the buyer, or creditor, Bahia Market bears the risk of ensuring that the delivery is completed successfully. Because it is the one that has this risk, the Market will be in charge of the transfer.

**Discussion Questions**

1. What happens if the Market pays a bus to deliver the produce but the bus gets into an accident and all of the food is destroyed?
2. Now imagine that instead Franco suggests to the owner of Bahia Market that he should use a bus driver Franco trusts, and the owner follows the suggestion. Then the bus driver steals all of the cashews and sells them for a profit. Is the owner of the market still responsible for the loss during the transfer?

**Answers**

1. Under Article 730, the Market must bear the burden of whatever goes wrong in the transfer. “Bearing the burden” here means being the one at risk of losing money if anything goes wrong. Because the bus crashed while the products were being transferred, Bahia Market still has to pay for them the same as if they had received them.
2. If the court finds that Franco actually caused the loss and is responsible for it, then the court can hold the seller (debtor) accountable for the loss during transfer under Article 730. Remember, if the Court decides to hold the seller, Franco, accountable for the loss due to his fault, this would constitute an exception to the general rule. Normally when goods are travelling it is at the buyer’s risk.

Example 3

Belinda bought a stereo and speakers and wanted them to be delivered to her together. Instead, the seller, Senor Bautista Gonzalez is just bringing her one piece of equipment at a time as he gets them.

### Discussion Questions

1. What should the court decide if Belinda complains that Senor Bautista Gonzalez is rendering performance one piece at a time instead of all at once?
2. Now imagine that, because of Belinda's request, Senor Bautista Gonzalez agrees to deliver the entire stereo at once. However his schedule is busy with deliveries and when he goes to bring the full stereo to Belinda she was not home. Because he is in a hurry, but he wants to complete the delivery, he decides to leave the stereo at Belinda's sister's house. However, he didn't know that Belinda was in a feud with her sister. Because they don't get along, when Belinda's sister got the package that was for her sister she destroyed it. What can Belinda do? Has Senor fulfilled the contract?

### Answers

1. Article 697 says that the court should consider what the parties agreed to in their contract as well as looking at local custom. The default rule is that without an agreement to perform the contract or deliver the object one piece at a time the performance should happen all at the same time. The exceptions to this rule are for if there is an agreement to the contrary, a custom in the industry for performing one piece at a time, or a law that allows it for a specific type of contract. Since the parties didn't agree to having the performance take place one piece at a time, and there is not a law about this, the court should consider whether there is any relevant custom on rendering performance in parts for stereos. If there is not such a custom, Senor Bautista Gonzalez is violating Timor-Leste Civil Code Article 697.
2. According to Article 704, performance rendered to a third party generally does not extinguish the obligation to the creditor. There are a few exceptions to this rule, for example, if the creditor approves of the performance being rendered to the third party or if the third party had acquired the credit from the creditor. Review Article 704, parts (a) through (f) for the full list of exceptions. In this case, because none of these applies, Senor has not fulfilled his end of the contract and he still owes Belinda a stereo.

### Example 4

Sonia wants to expand her garden. To get ready, Malia drafts an agreement to sell Sonia several farm items, including a goat, a tractor, and some smaller goods like shovels and seeds. They agree that the items will be ready for sale in a week.



### **Discussion Question**

Malia knows you are a law student, so she asks your advice: where should contract performance take place? Which Civil Code articles would apply?

### **Answer**

The first thing to do is look to the articles on location of performance. Articles 706-708 address location of performance. Article 706 tells us that consideration should generally take place “where the debtor is domiciled,” which means at the debtor’s home. Other Civil Code articles provide exceptions to this general rule. If the object of the contract is a movable asset, for example, Article 707 tells us that the performance should take place where the asset was when the parties signed the contract. For a financial obligation, the debtor should pay the creditor at the creditor’s domicile. The items Sonia wants to buy are movable assets, so according to Article 706, the performance should be rendered where they are located. Since these items are located at Malia’s home, the performance should be rendered there. Article 708 only applies to financial obligations and would not apply here.

## CHAPTER 4: NON-PERFORMANCE, ENFORCEMENT, AND REMEDIES

### CHAPTER OBJECTIVES

- To understand the ways in which a party may fail to perform a contract
- To explore cases which may excuse non-performance
- To learn about the various remedies available to the injured party in the event of non-performance

### I. INTRODUCTION TO NON-PERFORMANCE

The first section of this chapter will discuss what non-performance means, how it is legally established and what liabilities it creates. The following section will cover the situations in which non-performance may be excused, freeing the non-performing party of liability. The final section will cover the various remedies available to the party that suffers from non-performance, which we will call the “injured” party.

#### 1. What does non-performance mean and how is it legally established?

Article 732  
Liability of the Debtor

A debtor that negligently fails to fulfil an obligation becomes liable for the damages caused to the creditor.

Article 747  
Requirements

The creditor is in default when, without a *justa causa*, he or she fails to accept consideration that is lawfully offered or fails to do what is necessary for the fulfilment of the obligation.

Non-performance occurs whenever one party in a contract does not perform an obligation under the contract. According to the general principle set forth in Article 732 of the Civil Code, the party who unjustifiably (or “negligently”) fails either to perform their contractual obligations,

performs the obligations in a way that is defective or wrong, or performs at a later time than what they agreed to, will be liable for all the loss caused to the other party. Alternatively, under Article 747, a party may be in default when he or she does not accept performance by the other party without a good cause for rejecting it.

For example, imagine that Marco is contracted by Veronica to build walking path outside of Veronica's house, but the tiles he uses are cracked, causing injury to anyone who touches them. This means that the walking path is defective and that Veronica can sue Marco for non-performance under Article 732. However, if Marco completed the path without any defects but Veronica refuses to pay him for his services without a good reason, then she is a liable under Article 747 and Marco can sue her for non-performance.

Article 739  
Time at Which Default is Established

1. The debtor is only deemed to be officially in default after being judicially or extra-judicially notified to fulfil the obligations.
2. Independent of notification, default by the debtor exists:
  - (a) If the obligation has a specific deadline;
  - (b) If the obligation arises from an illicit act or fact;
  - (c) If the debtor himself or herself blocks the notification, in which case notification is considered to have occurred on the date on which the notification would normally have taken place.

What does a judge do once a lawsuit is filed and the parties appear in court? A judge faced with a case against a non-performing party will have to make a legal determination about whether the non-performing party is at fault for not performing or if they have a legally acceptable reason for not performing. If the judge decides that the non-performing party does not have a good reason for not performing then the court will provide legal notice under Article 739, informing the party of its decision.

Without such notice from the court, the defaulting party is not officially liable for damages except in three other circumstances. Those circumstances where the party is liable for default even without legal notice include 1) if the obligation has a specific deadline that has passed, 2) if the obligation arises from an illicit act or fact, or 3) if the debtor blocks the

notification. In these three cases, Article 739 states that the party is legally liable even if they do not receive notice.

What can the defendant do to protect from liability? To defend against a finding of liability, Article 733 puts on the defendant the burden to prove that he is not at fault.

Article 733

Presumption of Guilt and Judgment Thereof

1. It is incumbent on the debtor to prove that he or she is not to blame for the non-fulfilment or faulty fulfilment of the obligation.

Article 734

Acts of Legal Representatives or Assistants

1. The debtor is liable to the creditor for the acts of his or her legal representatives or the people he or she uses to fulfil the obligation, as if such acts were performed by the debtor himself or herself.

2. The liability may, by mutual consent, be excluded or limited, by means of prior agreement of the interested parties, provided the exclusion or limitation does not encompass acts that represent a violation of the duties imposed by the rules of law and order.

Note that, under Article 734(1), the defendant's responsibility extends to any "assistants" and "representatives" who helped him in carrying out his obligations under the contract. Thus, using our earlier example, if Marco had two of his employees helping him build the walkway, he is not protected from liability just because these employees were responsible for laying the tiles. Because these employees were his "assistants," the court must consider any mistakes they made to be the same thing as mistakes made by Marco.

Now let's say Veronica brings Marco to court because the walking path is defective. How would he defend himself? One way is by showing that full performance was not possible and that the impossibility was not his fault. The next section discusses how the defense of impossibility works. Alternatively, he might show that he and Veronica had an earlier agreement to waive liability, meaning to not require him to pay for damage he created, or limit liability, meaning to not make him pay for all of the damage he caused. The liability of a party who fails to perform may generally be eliminated or limited under Article 734(2) by an earlier agreement between the parties, as long as excluding or limiting liability does not represent a violation of the duties imposed by the rules of law and order. If Marco and Veronica specified in their contract that, no

matter how badly the walking path was built, Veronica would still pay Marco for his work, then a court will require Veronica to pay unless the court decides that having a broken walking path violates the rules of “law and order.” A broken walking path might be dangerous but it is generally not considered to go against the rules of law and order, so Marco would probably win.

## II. WHEN IS NON-PERFORMANCE EXCUSED?

### 1. Impossibility of Performance Not Caused by the Debtor

As stated in the previous section, Article 734 of the Civil Code usually allows the liability of a party who fails to perform to be eliminated by a prior agreement between the parties. However, if such an agreement does not exist, non-performance of a contractual obligation will only be excused if consideration becomes impossible through no fault of the party. “Consideration” in this case means the same thing as performance. Under Article 724, a valid excuse establishes that the non-performance is not the party’s fault, and therefore the obligation of the party is extinguished and the party is free from the contract. However, if consideration becomes impossible through some fault of the party, the party is still liable.

Article 724  
Objective Impossibility

1. The obligation is extinguished when consideration becomes impossible through no fault of the debtor.
2. When the deal from which the obligation arises has been done subject to conditions or for future fulfilment, and consideration is possible on the date on which the deal is concluded but becomes impossible before the conditions materialize or before the future due date, the impossibility is considered to be supervening and does not affect the validity of the deal.

For example, suppose Manuela owns a farm in Ermera and hires Paulo, a farmer, to grow coffee on the land for one year. Unfortunately, it becomes impossible for Paulo to start growing the coffee because the plants die from a foreign breed of poisonous flies which mysteriously invade the farm. Assuming Paulo took all the proper precautions to prepare the land for coffee and did not do anything to cause the insects to invade the region, this impossibility is not his fault, and thus his non-performance is excused.

Article 724 (2) establishes that if the performance is subject to a condition and is possible at the time the contract is form but becomes impossible while the condition does not occur, then impossibility is considered to be a supervening event and does not affect the validity of the contract.

Article 726  
Temporary Impossibility

1. If the impossibility is temporary, the debtor is not liable for the delay in fulfilment.
2. The impossibility is only considered temporary so long as, considering the purpose of the obligation, the creditor's interest is maintained.

Under Article 726, if the impossibility is temporary and the party is eventually able to perform on the contract such that the counter-party's interest is unaffected by the delay, then there is no liability for the delay. For example, if the poisonous flies left the area after one month, and somehow Paolo was able to resume growing the coffee, that delay would not count as non-performance. Thus, Paolo would not be liable for the loss in coffee revenues for the one month that the flies were present, but he would still be responsible for fulfilling his obligations for the rest of the one-year contract.

**2. Does a remedy exist for the injured party when non-performance is excused?**

Where a party's non-performance is excused under the articles above, the injured party may resort to a limited set of remedies that does not include monetary damages (which will be discussed in more detail in the next section).

Article 727  
Partial Impossibility

1. If the consideration becomes partially impossible, the debtor is exonerated through the provision of what is possible; in such cases, the consideration to which the other party is bound shall be reduced proportionately.
2. However, a creditor who justifiably has no interest in the partial fulfilment of the obligation may terminate the deal.

Under Article 727(1), if performance on the contract becomes partially impossible through no fault of the party responsible for it, then that party's obligation will be discharged as long as they perform the contract to the fullest extent possible given the circumstances. Note that the injured party's obligations are also reduced proportionately, meaning reduced in the same amount, in such a situation. For example, imagine that Paolo successfully fulfilled his coffee-

growing obligations for 6 months before the invasion of the flies poisoned the soil. In this case, he will get paid for the first 6 months of work but will be excused from working the next 6 months because of the impossibility created by the flies. The reduction is proportional because Manuela also has reduced responsibilities; instead of having to pay Paolo for a full year worth of work, Manuela only has to pay him for six months worth of work.

Article 727(2) allows a party to terminate a contract if he can show that his interest is completely lost through partial impossibility. Assume that, in the example from the last section, while Marco is still constructing the walking path, a mudslide comes through the area, destroying the front area of Veronica's house and making it impossible to build a walking path through that area up to where the front of the house used to be. Because a walking path that doesn't go anywhere is useless to Veronica, she and Marco can terminate the contract, freeing both parties from their remaining obligations. However, as will be discussed in the remedies discussion of this chapter, termination does not affect the rights and liabilities that the parties have earned up to the time of termination. Thus, Marco can ask to get compensated for the work he has already done.



### **III. WHAT REMEDIES ARE AVAILABLE TO THE INJURED PARTY IN THE EVENT OF NON-PERFORMANCE, AND WHEN?**

#### **1. Introduction to Remedies**

When non-performance of a contractual obligation is not excused by impossibility as discussed in Section II above, the injured party may commence a suit to enforce the contract. This does not mean, of course, that the victim of non-performance will always sue the non-performing party. Non-performance is most often settled by negotiation or methods of resolution other than litigation in court, such as traditional mediation. Very often, the victim may decide not to sue because the amount at stake is too small to make it worth the expense of litigation, or because of the difficulty of proving that they suffered economic injury, or because the non-performing party has no money with which to pay any judgment that may be won in court. Lawyers should always keep in mind the possibility of cheaper informal or non-judicial dispute resolution. This is because the cost of litigation and the problems with actually implementing the court's judgment often mean that it is better for your client to resolve the dispute another way. However, sometimes it makes the most sense to go to court. Even in cases where you are unsure about going to court, it is good to know what will probably happen if you did go to court. This is because knowing what the judge is likely to decide that your client's rights and obligations are always gives your client the chance to change their mind and go to court if that is the better option. Accordingly, this section will focus on the principles that the court will use to govern the choice of remedy, or solution, for non-performance. It will also look at the way that the court decides the amount of compensation to be awarded.

If the injured party decides to go to court and succeeds in showing that non-performance has occurred, the injured party will then argue for the judge to award one or more of the remedies that are possible in the law. Sometimes more than one remedy will be awarded in combination by the court; though some types of remedies cannot be awarded together. Below we will first discuss the goals of remedies in general. After that, we will begin to look at the various remedies available and explain the criteria, exceptions, and unique rules that apply to each.

## **2. The Basic Goal of Remedies**

A valid contract allows each party to have future expectations about what will happen. Both parties should be able to expect that the other party will honor their promises and do what they said they would do. If one of the parties fails to perform on an obligation, then the expectations of the other party will be damaged. Therefore the basic goal of the law in providing a remedy is to cure the injury created by a broken expectation. To do this, the victim of non-performance is given what they were promised under the contract or the equivalent value in money. Therefore, the ideal goal of remedies is to place the injured party in the position that they would have been in had the contract been fully performed.

## **3. Contract Remedies Principles**

### *Introduction*

Generally the most direct and accurate way of enforcing the injured party's expectations under the contract would be for the court to require "specific performance." Specific performance is an order by the court requiring the non-performing party to perform exactly as it promised. However, in some situations it is impossible or a bad idea for other reasons to demand specific performance. For example, suppose Jorge contracted for a restaurant in Dili to bake a big chocolate cake for his birthday party on July 9<sup>th</sup>. If the restaurant fails to bake the cake Jorge is disappointed by their non-performance. However, it would not make sense for the court to then order the restaurant to bake the cake on a different day because Jorge will not want the cake anymore. Because Jorge wanted the cake only on a special day for a special occasion, specific performance will not be the best solution. Because specific performance is not a good solution for him, he might ask a court to require the restaurant to pay him his money back, a remedy called monetary damages.

Alternatively, imagine that he had promised to pay only half the price of the cake when he placed the order with the restaurant, and said he would only pay the other half when the restaurant delivered the cake on his birthday. In this case, he might ask the court for the money he has already paid and ask the court to terminate the rest of the contract. In this case then, he is relying on three different remedies at once. These three remedies are:

- 1) Monetary damages: Monetary damages means getting his money back, in this case through the court.

2) Cancelling: Canceling, also known as “withholding,” is when he cancels his own performance on the rest of his own obligations, which in this case means refusing to pay the remainder of what he owes for the cake.

3) Termination: Termination means cancelling the contract and both sides’ remaining obligations. He no longer needs to pay the rest of the money and the restaurant no longer needs to bake the cake.

Each of these different remedies will be discussed in more detail below.

### Specific Performance

The Civil Code sections governing the specific performance remedy are as follows:

#### Article 751 General Principle

If the obligation is not voluntarily fulfilled, the creditor has the right to judicially demand fulfilment and enforce collection against the debtor’s estate, pursuant to the terms of this Civil Code and the laws of procedure.

#### Article 761 Delivery of a Particular Thing

If the consideration consists of the delivery of a particular thing, the creditor may opt to petition, in the enforcement proceeding, for the delivery to be made judicially.

#### Article 762 Consideration of a Fungible Thing

The creditor of a fungible thing may opt to petition, in the enforcement proceeding, for the thing to be delivered by another person at the debtor’s expense.

#### Article 763 Refraining from Consideration of a Thing

1. If the debtor is obliged to refrain from something and then does it, the creditor has the right to demand that the work, if the work has been done, be demolished at the expense of the one who undertook not to do it.
2. The right granted in the preceding paragraph ceases, giving way to indemnification only, in general terms, if the loss to the debtor with the demolition is substantially greater than the loss suffered by the creditor.

Article 764  
Mandatory Pecuniary Sanction

1. In obligations involving the consideration of a fungible thing, or refraining there from, except those requiring scientific or artistic qualities on the part of the obligor, the Court must, upon petition of the creditor, sentence the debtor to the payment of a pecuniary amount for each day of delay in fulfilment or for each infraction, whichever is more appropriate to the circumstances of the case.
2. The mandatory pecuniary sanction provided for in the paragraph above shall be established based on the criteria of reasonability, without prejudice to the indemnification applicable.
3. The sum of the mandatory pecuniary sanction is intended to be paid, in equal parts, to the creditor and to the State.

First and foremost, under the general principle laid down in Article 751, the injured party is entitled to enforce their rights under the contract and demand performance of the obligations that have not been performed. Basically specific performance is a way to demand the non-performing party to give consideration. For specific performance to happen, the consideration must be already stated specifically so there is no doubt about what the debtor owes to the creditor.

When a Third Party Can Replace Performance

Where the obligation involves an action to be taken and that action may be taken by a third party without injury to the injured party, a judge will order performance of the obligation by a third party at the expense of the non-performing party under Article 762. That means that the third party will fulfill the same obligations that the non-performing party should have performed and the court will force the non-performing party to pay the third party for doing it. For example, suppose a house painter named Ronaldo contracts with the Pereira family to paint a beautiful new house the family has bought in Baucau, but Ronaldo cannot come to do it because he has injured his back by playing soccer. In this case, a court would tell either Ronaldo or the family to find another painter to paint the house and would make Ronaldo pay the replacement painter to do the job in his place. The family would still need to pay Ronaldo, but if the amount that Ronaldo was getting paid to do the job was less than the amount the replacement painter needed to get paid to do the job, Ronaldo will have to pay the painter the extra money from his own wealth. Because if Ronaldo was not yet paid the court might be afraid that he would just

keep the money if he was paid directly, the court might tell the family to instead directly pay the replacement painter instead of Ronaldo. Then the court would order Ronaldo to pay the family any extra money that the replacement painter cost more than the amount Ronaldo was going to charge. This rule makes sense because it prevents the family from being disappointed by Ronaldo's breach. The family is not disappointed since they paid the same amount of money that they would have paid Ronaldo and still got their new home painted. Ronaldo is disappointed since instead of making money by painting a house he had to pay someone else the extra amount that they charge to paint the house instead of him, but in contract law we do not care about disappointing the breaching party. The goal of remedies in contract law is to make the non-breaching party's expectations come true and to not have them lose anything from the other party's breach. Because we want to discourage parties from breaching or not fulfilling their promises and duties, we don't mind them losing money if they breach.

In the same way, when a party is supplied with defective goods, they are entitled to require from the supplier of the defective goods that they be repaired or replaced by goods that are not defective. If the supplier is not able to provide these goods, the party is allowed to get the goods elsewhere and require the first supplier to pay for them, even if they are more expensive at the second place. So if the Pereiras bought a new air conditioner for their living room but it does not blow cold air, they have the right to ask the store to replace it. If the store is unable to replace it, the Pereiras can go to another store and buy a new air conditioner to replace the one that doesn't work and then can require the first store to pay them the cost of the air conditioner at the second store.

#### When a Third Party Cannot Replace Performance

Under Article 764, where the breached obligation involves something that cannot be done by a third party without more injury to the injured party, the non-performing party will have to pay a fine for every day, or every action, that the non-performing party does not fulfill the obligation. This means that if the non-performing party cannot be replaced, he can be compelled to complete his obligations by being fined for delaying. For instance, imagine that there is only one person in Timor-Leste who is trained to work on a particular complicated piece of machinery that is used at a new oil refinery that has been built in Timor. This same person installed it and assembled this piece of machinery in the oil refinery and he guaranteed that it

would work. Unfortunately, the item is not working because the person who installed it forgot to include a small part and he is the only one who can fix it. If the installer does not come back to the refinery to fix the thing that he broke because he does not want to have to pay to travel to the refinery and to then work there to fix it for free, then the court can make him pay a daily fine until he comes and fixes the piece of machinery.

However, there are limitations to compelling a non-performing party to perform. As a result, specific performance is not always available to the injured. One limitation on specific performance in Article 764 regards actions that require the non-performing party to possess specific scientific or artistic qualities. The non-performing party cannot be forced to do something that requires him to use his scientific or artistic skills. This rule would apply if the Pereiras hired a singer to give weekly singing lessons to their daughter Carla, but the singer quits. Even if there are no other singers available to teach singing lessons, the teacher cannot be forced to come back and teach. Most likely, then, the Pereiras will terminate the contract and ask for any money back that they had paid her in advance.

The reason that this rule exists is that the law knows that it is difficult to make someone do a good job at something if they don't want to. When the job that the person has to do is one where it is easy to tell if the person has done it correctly or not, like fixing a piece of machinery at an oil refinery so that it works, then the law will make the person do it. However, if the job is the kind of job where it is very difficult to know if the person is doing it as well as they can or not, like teaching someone to sing, the law does not force the person to do it. That is because, if someone is forced to do a job, they are likely to be unhappy about it and to not do a good job. If they have to do a good job even if they don't want to because it will be obvious if they do a bad job, then the person can be forced to do a good job. But if the job is the kind of job where how well someone is doing it is less clear, and less easy to measure, then it is easy for that person to not try as hard and not do as good a job. When a person is doing work that is artistic or scientific, it is very easy for the person to either not do the best and most creative art they could do, or not do the hardest scientific thinking and investigation they could do. In both of those cases, no one would be able to tell if they were really fulfilling their obligations as seriously as they should. Because the goal of remedies is to give the person back what they lost from the breach, the law cares about this difference. When it is possible to monitor and watch the person doing the specific performance and make sure that they are doing it right, then specific performance is the

best solution to make sure the victim of the breach gets what they deserve under the contract because they get exactly what they contracted for. However, when we cannot tell if the person is doing the work well, and we think that they do not want to do it well, then having them do specific performance does not really give the victim back the same thing that they bargained for. That is because they bargained for good artistic or scientific work, but instead, with specific performance as the remedy, what they got was lower quality scientific or artistic work. Lower quality work does not fill their expectations of high-quality work. Because of this difference, the law does not use specific performance as a remedy for scientific or artistic work. Also, because of the problems with specific performance more generally, and the fact that people don't like to be forced to do things, the court likes to avoid forcing specific action whenever possible. It is only in cases where no one else can do the work instead, and where the work can be easily monitored, that the court will require a person to perform specific performance.

Under Article 763, where an obligation of the contract involves agreeing to not to take some action, and a party breaches the obligation by taking such action, the court must rule that the breaching party must destroy the result of such action at its own expense. However, Article 763 protects the non-performing party in certain cases. One of these cases is if destroying the thing done in breach would cause the non-performing party to suffer a much bigger loss from the destruction than what was already suffered by the injured party. In that case the court allows the breaching party to not destroy what they've done. For example, imagine that one neighbor, Alves, contracted with his neighbor, Pires, agreeing not to build a house on part of his property since it would block the sunlight that Pires' house gets. In the agreement, Pires gave Alves \$100, to build his house on a different piece of his property because he did not want Alves's house to block sunlight to his house. Then, several years later, despite the agreement, Alves builds a very large, very expensive house on the spot where in the contract he agreed he would not build his house. Pires is very angry with this because he paid Alves to not build his house there and he did so anyway, and now Pires' house does not get very good sunlight. Because of this, Pires goes to court to sue Alves, and asks that the court make Alves destroy the house that he built where he agreed not to build it. In this case, the court is likely to not make Alves destroy the house he built, even though building the house was a breach of contract. The reason for this is that under Article 763, the court has to consider fairness. While it was unfair of Alves to build his house where he did, it would be even more unfair to require him to tear down his house. This is

because the amount of damage that Alves did to Pires by breaching the contract and blocking sunlight to Pires house is much smaller than the amount of damage Alves would have to suffer if he had to tear down his house. Article 763 says that in cases where the amount of loss that the debtor would suffer from demolition “is substantially greater than the loss suffered by the creditor,” than the court can require monetary compensation, which the statute calls “indemnification,” instead of demolition. In this case, the court would let Alves keep his house but would make Alves pay Pires money for the damage he caused to Pires by breaching the contract and blocking the sunlight.

### Monetary Damages

#### Article 497 General Principle

He who is obligated to indemnify shall restore the situation that should exist if the event giving rise to the indemnity had not occurred.

#### Article 498 Causal Link

Obligation to indemnify shall only exist with respect to a damage which the injured person would probably not have incurred if injury had not been produced.

Notice how the Civil Code, in Articles 497 and 498, explains what the goal of the monetary damages remedy is. It is the same goal that we discussed earlier in the introduction; to place the injured party in the position that he would have been in if the contract had been fully performed. The goal is to make it as though the breach had never happened. To do this, the party that breaches is required to pay all of the damages that the breach caused, and also to pay all of the benefits that the non-breaching party expected that they would get from the contract.

#### Article 499 Indemnity Calculation

1. Obligation to indemnify shall cover the damage caused as well as the benefits the injured person has no longer been able to obtain as a result of the injury.



2. In calculating indemnity, court may look to the coming damage as long as it is predictable; if it is not determinable, calculation of the corresponding indemnity shall be made later.

The general measure of damages, as stated in Article 499, is an amount that will put the injured party as nearly as possible into the position that it would have been in had the contract been fully and properly performed. Generally, such damages should cover both the loss that the injured party has suffered and the gain that the injured party would likely have made if the contract had not been breached. In cases where it is not clear how much damage was caused by the breach, because more damage is expected to happen in the future, the court can either predict how much damage will probably come in the future and award that amount, or wait and award damages later on when they become clearer.

The goal of remedies is to provide “expectation damages,” meaning to provide the amount of value that was damaged and lost by the breach compared to what was expected from the contract. However, it is important to realize, that the remedies courts actually award do not always achieve this goal. There are many things that can stop the law from achieving the same result that full performance would have achieved. These include:

- **Foreseeability:** It is not always fair for the defendant to be responsible for liabilities that it was not reasonable to predict, or “foresee,” at the time of contracting. For example, if a party failed to refill a tank of gas in a car after they used it, it would not be fair to make them pay for a car accident that a different driver got into in the vehicle when it ran out of gas on a steep hill. That is because the person who forgot to refill the gas could not have thought that not refilling the gas would cause a car accident, since that is such a strange and unexpected thing to happen. If there are damages that could not have been foreseen, then the court might rule that they should not be awarded.
- **Injured Party’s Fault:** The injured party also has a responsibility not to increase the amount of losses that they suffer. That means that the injured party must do things to make sure that the amount that they lose because of the breach is as small as possible. If they do not do this, and instead try and increase their losses with the expectation that the party who breached the contract will have to pay for these extra losses, the court will not make the party who breached pay these extra expenses. Under Article 501, the defendant will not be liable for losses caused by the injured party.

- **Causation:** As Article 497 hints, the non-performance must be the cause of the losses for the court to require compensation. That means that the party who breached the contract is not responsible for losses that happened mostly for reasons that did not have to do with his non-performance. This can sometimes mean that the compensation is not really complete. This is because the non-performance might have been a partial cause of some losses, but because it wasn't very clearly a large cause, it doesn't get awarded very much. This does not mean that the court can't award damages for being a breach being a partial cause, just that because it is very difficult to determine how much was caused by the defendant's breach, the court might not award enough compensation for this.
- **Reasonable Certainty:** Obviously, the plaintiff must be able to convince the judge that he has suffered or will suffer an injury. In addition, the amount of the losses must be based on a level of proof that is fair to the defendant. Thus, under Article 499(2), which appeared above, if a judge is not sure about the damage calculation, then he can wait to make the calculation later. Similarly, Article 500 and 501(3) require damages to be limited to those that are already proven. All of this means that some damages that are difficult to prove or be certain about may never be compensated, even if the court tries to compensate everything.
- **Proportionality:** As we saw in Articles 763 and 764 from our discussion of specific performance; when the burden of the defendant's liability is much bigger than the injury to the plaintiff, then the court has the ability to decide to limit the liability of the damages in order to be fair to the breaching party. Here it might be the case that the victim of the breach never gets what they would have gotten if the contract had not been breached. Still, the court can try to compensate for this as much as possible by, for example, rewarding high monetary compensation instead. If the court is able to award enough monetary compensation in place of a very expensive specific performance remedy, it is even possible that the victim will be adequately compensated for the breach. This could happen if the victim is just as happy with the amount of money that they were given as they would be with the specific performance.

With these general concerns in mind, below are the major sections governing monetary damages. Note that the Civil Code uses the term "indemnification" as another way to say payment of monetary damages.

Article 500  
Provisional Indemnity

If indemnity is to be calculated at the time of judgment execution, the court may nevertheless from the beginning condemn debtor to pay damages limited to the amount deemed to be already proved.

Article 501  
Indemnity in Money

1. Indemnity shall correspond to a money amount whenever natural restoring is not possible, does not completely indemnify for the damage caused or is hugely expensive for the debtor.
2. Without detriment to any other provision regulating this subject matter otherwise, indemnity in money shall correspond to the difference between the patrimonial situation of the injured person at the most recent time the court can look to and the patrimonial situation he should have at that time if damage had not been produced.
3. In case the exact value of the damage cannot be confirmed, the court shall decide equitably within the limits that are deemed to have been proved.

Article 505  
Injured Party's Fault

1. When a faulty act on the part of the injured person has contributed to produce or increase damage, the court shall be competent to decide, upon measuring the levels of fault of both parties and the effects which have arisen therefrom, whether indemnity shall be totally accorded or reduced or even excluded.

In keeping with the general principle that specific performance is the first remedy that should be considered, Article 501 states that the injured party is entitled to monetary damages only if it is impossible (due to a fault of the non-performing party), incomplete, or too costly for the non-performing party to specifically perform the contract. The point of the money damages is to put the injured party as closely as possible into the position that they would have been in had the contract been fully and properly performed. To review, the plaintiff, meaning the victim seeking damages, would likely ask for money damages where specific performance will not be possible to satisfy the plaintiff's expectation. Specific performance may not be possible for the following reasons:

- **Impossibility:** If the restaurant in Dili bakes Jorge's birthday cake a day after Jorge's birthday party, it is too late for Jorge to enjoy the cake on his birthday. That means that

there is no possible way to have the specific performance of a cake delivery on Jorge's birthday. Therefore money damages are a better option.

- Incompleteness: If the painter of the Pereiras' mansion agreed in the contract to finish the house by the night of the party but finished only half of the house by that night, then finishing painting will not be adequate performance to fully satisfy the obligation.
- It is too expensive for the defendant: The cost of rebuilding a new house is much more expensive and much more of a burden than the loss of value of having sunlight blocked.

### Measuring the Amount of Damages

Imagine that for one the reasons above, a plaintiff asks for monetary damages. What happens next? First, according to Articles 499-501 of the Civil Code, the court will try to calculate the amount of damages with a reasonable amount of certainty. This is usually done by proving damages that have already occurred and those that are fairly certain to occur in the future. For example, imagine that the Pereria family hosts a "bossa nova" performance at their mansion, and they sell all one hundred tickets for the performance, costing 10 US dollars each. If the musicians then do not show up for some unjustified reason and the Pereieras have to cancel the show and return the ticket prices, they can sue the band for 1,000 US dollars in money damages. They can sue for this because they can prove these losses by showing the amount they lost in ticket sales. Now imagine the Pereria family is so angry at the band that they request the court award them 100,000 US dollars in damages. Will they be able to get this money? No they will not, because they only had \$1000 dollars worth of ticket sales, plus some extra expenses, that is the most they could have lost . They might try to show how their reputation was harmed by the cancellation of the show that night, but this will be hard to prove in court until they have proof that future shows will sell fewer tickets as a result of this cancellation. As Article 499(2) points out, a court will usually not want to give damages for future losses until they have an accurate idea of how much was lost.

### Injured Party's Fault

Under Article 505, the non-performing party will not be liable for the loss suffered by the injured party for the amount of money that the injured party contributed to their own loss. This means that the non-performing party will not have to pay for the amount of damage that the

injured party did to himself. Thus, the injured party has an obligation to limit damages once it knows that the contract will not be fully performed by the other side.

For example, imagine that in the case of the oil refinery mentioned before, there were lots of people that could fix the piece of machinery that was broken at the refinery. If the piece of machinery that the person installed breaks, and the person who installed it does not come out to fix it, if other people can fix it, the refinery is obligated to either hire someone else to fix it or to not require the installer to pay all of the damages for not coming out to fix it. So, imagine that if the piece of machinery breaks that the refinery losses a million US dollars a day for every day that it is not working. If the refinery could have hired someone else to fix the piece of machinery in one day, then the installer should only be responsible for the cost to hire the person to fix the machinery, and for the one million US dollars lost because of his breaching his guarantee in the contract that the machine would work. However, if the refinery does not hire someone else to fix the machine for 180 days, even though it easily could, the installer of the machine is not responsible for paying 180 million US dollars to the refinery in damages. That is because the refinery had an obligation to not make the damages worse. In this case, by not hiring a different person to fix the machine, they made the damages to themselves a lot worse. The non-performing party, the installer of the piece of machinery, is not responsible to pay for this damage that the refinery caused to itself.

### Penalty Clause

In addition, the parties can also limit any possible damages by including a provision in their contract called a Penalty Clause.

Article 744  
Penalty Clause

1. The parties may, however, by mutual agreement set the amount of the damages that may be demanded; this is called a penalty clause.
2. The penalty clause is subject to the formalities required for the principal obligation, and it is null and void if the obligation is null and void.

Article 745  
Functioning of the Penalty Clause

1. The creditor may not demand cumulatively, based on the contract, the coercive fulfilment of the obligation and the payment of the penalty clause, except if the latter has been established for delays in consideration; any stipulation to the contrary is null and void.
2. The establishment of the penalty clause bars the creditor from demanding indemnification for additional damages except as otherwise agreed by the parties.
3. The creditor may not under any circumstances demand an indemnification that exceeds the value of the damage resulting from the non-fulfilment of the main obligation.

Article 746  
Equitable Reduction of the Penalty Clause

1. The penalty clause may be reduced by the Courts, based on equity, when it is manifestly excessive, even if due to a supervening cause; any stipulation to the contrary is null and void.
2. Reduction is permitted under the same circumstances, if the obligation has been partially fulfilled.

The penalty clause represents a mutual agreement to set the amount of the damages that may be demanded. However, under Article 745(1), when a penalty clause exists, the injured party generally may not demand that the breaching party both perform on the obligation as well as make payment of the penalty clause. The exception to this is in rare cases where the penalty is paid for delays in performance. In addition, according to 745(2) the penalty clause may not in any circumstances lead to a damages remedy that exceeds the value of the damages resulting from the non-fulfilment of the main obligation. In fact, the court can reduce damages that are “manifestly excessive” meaning that are obviously a lot more than the actual damage. This is because the penalty clause is not designed to punish the breaching party, but is instead only supposed to make it easier for the victim of the breach to be made whole. Allowing for a penalty that is greater than the damages is unnecessary because it does more than make the victim whole, and would punish the party who breached too much. That is why excessive penalty awards are not allowed and the court will change them to be more fair. For example, imagine the Pererias’ contract with the bossa nova band described above included a penalty clause saying that an unjustified cancellation by the band would create a penalty of 100,000 US dollars. A court would rule that 100,000 US dollars was “manifestly excessive” because the amount is much greater

than the actual damages of lost ticket sales and other proven harms. The court here will limit the damage award to the amount actually lost and will ignore the excessive penalty clause.

### *Withholding Own Performance*

It is a generally accepted principle that a party, which must perform at the same time or following the other party's performance, may withhold his own performance until the other party has performed. This first party may withhold the whole of his performance or a part of it, whichever is reasonable under the circumstances. For example, imagine the Pereira family hires Bernardo to build a house for them and the contract provides that within two days of the contract being signed, the Perieras will make an advance payment of 1,000 US dollars to Bernardo. If the Pereiras do not make the payment in the two days after the contract is signed, Bernardo may withhold on beginning construction until he receives the money.

Note that even if the non-performance is relatively minor, the law still allows the injured party to withhold, provided the performance that is withheld is reasonable. For example, Alexandro agrees to buy a new car from Felipe's car dealership. When Alexandro comes to pick up the car he finds it has a scratch on the outside. He may withhold performance by refusing to take the car or pay any part of the price, until the car is repaired. This is reasonable because Felipe is a car dealer and should know how to get the car repaired without excessive burden on him. However, if Alexandro bought the car and had it shipped to his home in Australia, it would be unreasonable for Alexandro to expect Felipe to repair the scratch, since Felipe does not have any employees or facilities in Australia. As a result, the reasonable way to withhold performance would be to accept the car and send payment to Felipe, but to reduce the amount of the payment by the amount it will cost Alexandro to have the car repaired in Australia.

### *Reduction in Price*

Another remedy for an injured buyer is a reduction in price. This occurs when the injured party is the creditor and the breaching party owes the injured party a good or service. If the breaching party is breaching through non-performance or partial performance, than the injured party can reduce the amount that they will pay the breaching party. Article 428 discusses the situations in which this remedy can apply:

Article 428  
Limitation of Compensation in Cases of Mere Fault

Where liability is based on mere fault, compensation may be fixed equitably to an amount lower than that corresponding to the damage caused, provided that the degree of fault of the wrongdoer, the financial situation of the wrongdoer and of the injured party as well as the other circumstances of the case so justify.

Under the rule above, the reduction in price should be proportionate to, meaning the same percentage as, the decrease in the value of the performance caused by the defect. That is because the price reduction is not supposed to be a penalty to the breaching party but instead is a way of allowing the victim of the breach to not have their expectations damaged by paying full price for less than what the contract said they should receive. By letting the victim reduce the price, the victim is better able to get the value that they expected for the price that they expected; at least in proportional terms. As an example, imagine a coffee shop in Dili contracts to buy 50 boxes of coffee from Manuela's farm in Ermera at a price of 2,000 US dollars per box. This means that the total contract price is 100,000 US dollars. If Manuela is only able to send 30 boxes, then the shop may accept the delivery and reduce its payment from 100,000 US dollars to 60,000 US dollars. Alternatively, if the shop already paid 100,000 US dollars before delivery, it can reject the partial delivery and claim damages in the amount of 100,000 US dollars. Another option is that it can choose to accept delivery and ask for 40,000 US dollars to be returned as a price reduction.

Terminating the Contract

Termination is a remedy that releases both parties from their obligations to effect and receive future performance. When can the injured party ask for termination? In some situations termination will be the only remedy available to the injured party: for example, when the non-performing party is insolvent, meaning that they do not have any money, and cannot perform its obligations or pay monetary damages. However, even when the other party is not insolvent, if the breaching party's non-performance is so serious that it violates the contract, the injured party can ask to terminate the contract. A minor defect or a simple delay in performance is not enough of a reason for termination. To terminate the non-performance has to be very serious. For example, imagine again that Alexandro purchases a car from Felipe's dealership. The small scratch on the



body of the car will not be grounds enough to terminate the contract. That is because it is a very small type of non-performance. However, if the car does not drive, then that will violate the reason for buying a car and Alexandro will be allowed to terminate the contract.

In the case of a delay in performance, the injured party will be entitled to terminate the contract in only two circumstances. In the first circumstance, he is only allowed to terminate the contract if he has justifiably lost any interest in performance. This can happen when the performance needed to take place on a specific day in order for it to be worth doing. For an example of this remember the story of the restaurant which failed to bake a chocolate cake in time for Jorge's birthday. Because Jorge has no interest in the cake after his party is finished, Jorge will most likely terminate his contract with the restaurant, which means the restaurant no longer has to bake the cake and he no longer needs to pay for one. If he already has paid the restaurant, then the restaurant will need to pay him back. The second circumstance that can justify termination for delay is if the victim has given notice to the non-performing party of a second period of time within which performance can still be carried out. If the non-performing party fails to perform before this second deadline than the victim is allowed to terminate the contract. The idea here is that the victim only has to give the non-performer two reasonable opportunities to perform after which he can terminate the contract.

If only partial performance has been given, the injured party may terminate the entire contract only if he has no interest in partial performance. That means that if partial performance does not benefit the injured party, than the injured party is free to terminate the contract even though the other party has partially performed. For example, imagine that a fisherman asks a boat builder to build him a boat. Before the boat builder builds very much of the boat, he is seriously injured and can't finish it. In this case the fisherman does not need to pay the boat builder. That is because the purchaser of the boat has no use for part of a boat that is not complete. If a third party is able to finish building the boat for the fisherman, than the fisherman should pay for it, but if it is not finished, he should not have to.

The injured party may also terminate the contract even before performance is due if the defaulting party has made it clear that they will not perform their obligations under the contract. This means that the victim will be able to terminate the contract in advance if the defaulting party tells the victim that they will not perform, or makes it obvious from his actions that he will not perform. Imagine Bernardo agrees to build the Pereira family a house starting on May 1, but

in April he tells them that he cannot carry out the contract because of a labor conflict he is having with his workers. In this case the Pereira family may immediately terminate the contract.

Lastly, it's important to keep in mind that termination is not allowed if the injured party is the reason for the other party's non-performance. Termination is also not allowed if a third party or some other unrelated cause is primarily responsible for the non-performance.

#### **4. Relevant Civil Code Articles**

- Non-Performance: Introduction and Definitions
  - 732: Liability of the debtor
  - 733: Presumption of guilt and judgment thereof
  - 734: Acts of legal representatives or assistants
  - 739: Time at which default is established
  - 747: Requirements
- When is non-performance excused?
  - 724: Objective impossibility
  - 726: Temporary impossibility
  - 727: Partial impossibility
- What remedies are available to the injured party in the event of a non-performance, and when?
  - Specific Performance*
    - 751: General principle
    - 761: Delivery of a particular thing
    - 762: Consideration of a fungible thing
    - 763: Refraining from consideration of a thing
    - 764: Mandatory pecuniary sanction
  - Monetary Damages*
    - 497: General principle
    - 498: Causal link
    - 499: Indemnity calculation
    - 500: Provisional indemnity
    - 501: Indemnity in money

505: Injured party's fault

744: Penalty clause

745: Functioning of the penalty clause

746: Equitable reduction of the penalty clause

*Withholding Performance/Reduction in Price*

428: Limitation of compensation in cases of mere fault