

# Contractual obligations and debt recovery during the COVID-19 pandemic: To sue or not to sue?

June 2021

## Overview

The coronavirus disease (COVID-19) brought fast-moving and unexpected changes for which many existing businesses and establishments were unprepared to face. The unprecedented pandemic has left many in the state of flux, leading to the slow response in mitigating the resulting adverse financial and social impact.

In an attempt to alleviate the said impact, the Malaysian government passed the Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) Act 2020 (“the Act”), which came into force on 23 October 2020. It is clear from the title of the Act itself that it intends to provide for temporary reliefs from the adverse effects brought about by the COVID-19 pandemic.

This article has its focus on Part II of the Act, namely on the inability to perform contractual obligations. Part II of the Act has retrospective effect from 18 March 2020 and shall remain in operation until 30 June 2021, unless further extended by order published in the Gazette.

## The Law

### a) Inability to Perform Contractual Obligations

Section 7 of the Act provides as follows:

“The inability of any party or parties to perform any contractual obligation arising from any of the categories of contracts specified in the Schedule to this Part due to the measures prescribed, made or taken under the Prevention and Control of Infectious Diseases Act 1988 [Act 342] to control or prevent the spread of COVID-19 shall not give rise to the other party or parties exercising his or their rights under the contract.”

In short, Section 7 of the Act bars the enforcement of a contractual right against a defaulting party (effectively, a moratorium on any enforcement action) who shows that there is an inability on their part to perform a contractual obligation. The said contractual obligations must arise from one of the categories of contracts provided in the Schedule of the Act. Further, the inability to perform such contractual obligations must be due to the measures prescribed, made or taken under the Prevention and Control of Infectious Diseases Act 1988 (“PCID Act”). A distinct example of a measure taken under the PCID Act is the implementation of the Movement Control Order and its variations in Malaysia. As such, the Movement Control Order shall be referred to in this context in the course of this article.

### b) Categories of Contracts

The categories of contracts which fall under the Act, including the two new categories included pursuant to the

Temporary Measures for Reducing the Impact of Coronavirus Disease 2019 (COVID-19) (Amendment of Schedule) Order 2020, are:-

1. Construction work contract or construction consultancy contract and any other contract related to the supply of construction material, equipment or workers in connection with a construction contract;
2. Performance bond or equivalent that is granted pursuant to a construction contract or supply contract;
3. Professional services contract;
4. Lease or tenancy of non-residential immovable property;
5. Event contract for the provision of any venue, accommodation, amenity, transport, entertainment, catering or other goods or services;
6. Contract by a tourism enterprise as defined under the Tourism Industry Act 1992 and a contract for the promotion of tourism in Malaysia;
7. Religious pilgrimage-related contract;
8. Hire-purchase agreement as defined under the Hire-Purchase Act 1967 or leasing contract that has been entered into by micro enterprises, B40 or M40 class of persons for motor vehicles, goods or public service vehicles or tourism vehicles; and
9. Credit sales contract under the Consumer Protection Act 1999.

### **c) Savings provision**

Notwithstanding Section 7 of the Act, Section 10 of the Act provides that any enforcement of a contractual right, i.e. the termination of a contract, commencement of legal proceedings, grant of a Judgment and/or execution of the same, carried out between 18 March 2020 until the date of publication of the Act on 23 October 2020, shall be deemed to have been validly carried out.

### **What next for creditors?**

This article explores two potential options for debt recovery by creditors while Part II of the Act remains in force. For both options, as best practice, creditors may first wish to issue a letter of demand against the debtor for the debt owed to them arising from the relevant contract(s) between the parties. Although not a pre-requisite to the initiation of a suit in Court, the letter of demand puts the debtor on notice of the debt owed by them to the creditor and requires the debtor's settlement of the same within a stipulated period of time.

#### **a) Option 1: Withhold initiating legal proceedings**

In response to the letter of demand, the debtor may rely on the protection afforded under the Act by asserting that they are unable to pay the debt (i.e. unable to perform their contractual obligations) due to the Movement Control Order. In such a situation, the debtor will claim that the creditor cannot enforce their contractual right to recover the debt from the debtor for as long as Part II of the Act is in force. The onus is on the debtor to prove the same.

A literal interpretation of the provisions of Part II of the Act provides that the creditor is prohibited from exercising its right under the contract to seek recovery of debt from the debtor during the period of operation of Part II of the Act. In other words, the creditor cannot initiate legal proceedings against the debtor to recover the debt owed until the operation period of Part II of the Act lapses after 30 June 2021 (unless the operation period of Part II of the Act is further extended).

After the expiry of Part II of the Act, the creditor is free to enforce their contractual right by commencing legal proceedings against the debtor to recover the debt. However, it may be prudent and in the best interest of the creditor to issue an additional letter of demand to the debtor before the creditor proceeds to commence legal proceedings against the debtor.

#### **b) Option 2: Initiating legal proceedings**

If the letter of demand issued to the debtor is disputed on other grounds or unanswered within the stipulated notice period, creditors may consider initiating legal proceedings against the debtor to recover the debt arising from the relevant contract(s). However, creditors should note that debtors may raise Section 7 of the Act as a defence in the suit, i.e. that the creditor is not permitted to enforce their contractual rights via legal proceedings seeking to recover the debt, as the debtor is unable to perform their contractual obligations (flowing from contracts provided for in the Act) due to the Movement Control Order.

Similarly, the debtor bears the burden of proving on a balance of probabilities that their inability to perform their contractual obligations is due to the Movement Control Order. As at the date of publication of this article, there are no reported cases as regards the application and interpretation of Section 7 of the Act vis-à-vis the evidence and argument required to be presented by the debtor in order to prove that the case falls within the ambit of Section 7 of the Act. Nevertheless, by choosing this option, it is pertinent to note that creditors then expose themselves to the risk that the Court may accept the debtor's defence and as such, the legal proceedings initiated by creditors would fail as it is caught under Section 7 of the Act. As a result, creditors are prevented from enforcing their contractual rights and would have incurred additional costs and expenses in pursuing legal proceedings.

## Comments

It is recommended that creditors issue a letter of demand for outstanding debts to the debtor as the first course of action. The next course of action is dependent on the factual circumstances of each creditor's case; for example, commencing legal proceedings against the debtor during the operation period of Part II of the Act carries with it some risks for the creditor. However, the risks may be low, if on the available facts, it is unlikely that the debtor can successfully contend that their inability to perform their contractual obligation is due to the Movement Control Order.

Further, it should be borne in mind that Part II of the Act may be further extended beyond 30 June 2021, particularly in light of the current dire COVID-19 situation nationwide. Accordingly, while Part II of the Act remains in force, parties may consider solving their contractual disputes by way of mediation, as provided for in Section 9 of the Act. Kindly note that the mediation process is purely on a voluntary basis between the parties. If selected and the mediation results in the execution of a settlement agreement, the same shall be binding on the parties.

In this regard, please note that the Malaysian government has set up a COVID-19 Mediation Centre (PMC-19) to specifically resolve parties' disputes in respect of any inability to perform contractual obligations arising from any of the categories of contracts falling within the ambit of the Act due to the Movement Control Order, if the dispute sum does not exceed RM500,000.00. If the dispute sum exceeds RM500,000.00, parties may refer the dispute to the relevant Mediation Service Providers such as the Malaysian Mediation Centre (MMC), Asian International Arbitration Centre (AIAC) or any other private mediators.

---

Zain & Co. acknowledges **Hanna Suhaila Haizal** (Associate) and **Jia Yin Kuan** (Pupil-in-Chambers) for their contributions to this article. For further information or any related inquiries, please contact our Partner: Kok Su Ann

## Your Key Contacts



**Su Ann Kok**

Senior Partner, Kuala

Lumpur

D +603 2698 6255

[suann.kok@zain.com.my](mailto:suann.kok@zain.com.my)