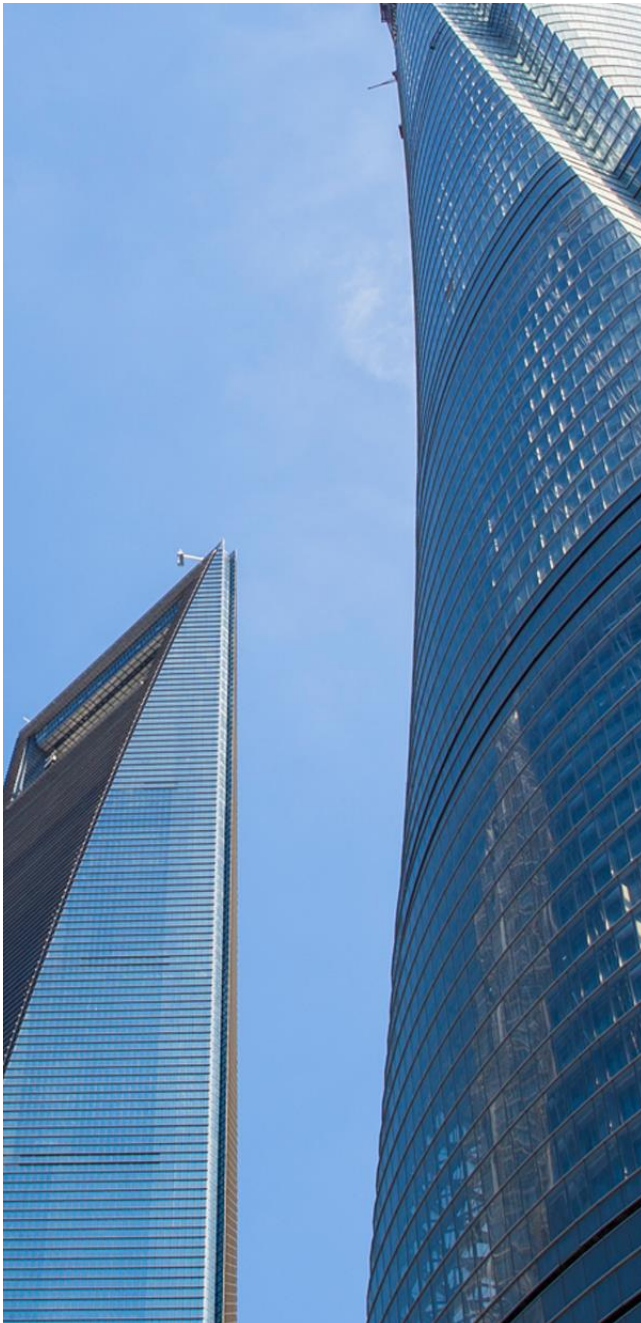

Contract performance during coronavirus outbreak

Corporate Legal flash

February 2020



Summary

On January 31, 2020, the outbreak of novel coronavirus (2019-nCov) was declared a Public Health Emergency of International Concern (PHEIC), the highest level of the infectious disease emergency response system, by the World Health Organization.

In the corporate practice area, it is necessary to explore and discuss how the outbreak may affect the contract performance of businesses from the perspectives of Chinese law.



Contract performance during coronavirus outbreak

Chinese authorities at national and local levels have taken a series of measures to prevent and control the epidemic situation resulting from the outbreak of the novel coronavirus (2019-nCov), including extending public holidays, delaying work resumption and imposing travel restrictions at home and abroad.

These measures will severely hinder business activities in mainland China, with ripple effects throughout Asia and beyond. Numerous companies in China and other places in Asia may face difficulties meeting agreed deadlines and deliveries with their customers. Meanwhile, these companies may also be subject to the risk of failing to comply with their commitments to their customers, as their supply chains will not be able to deliver on time.

This legal flash will briefly summarize the general legal impacts of the outbreak on the performance of commercial contracts under the law of China.

1. Is the coronavirus outbreak a *force majeure* event?

Force majeure generally applies to radical, external events that are not attributable to either party, such as natural disasters, outbreaks of war and strikes. We believe that the coronavirus outbreak may constitute a *force majeure* event.

The starting point for considering the impact of the coronavirus outbreak on the performance of a commercial contract under Chinese law is the language of the contract itself. If the contract explicitly includes a *force majeure* clause, the constitution of a *force majeure* event depends on whether the clause includes the outbreak and its effects or the nature of qualifying events; e.g., whether "infectious disease" is explicitly listed as a *force majeure* event in the contract.

If the contract does not contain a *force majeure* clause or a clause that addresses the outbreak, the parties may still claim that the outbreak of novel coronavirus constitutes a *force majeure* event based on the following legal provisions and judicial practices.

Legal provisions

Article 180 of the General Rules of the Civil Law of the PRC, article 153 of the General Principles of the Civil Law of the PRC and article 117 of the PRC Contract Law, generally define *force majeure* as "objective circumstances that are unforeseeable, unavoidable and insurmountable."



We believe that the coronavirus outbreak could not have been foreseen by the general public and was unexpected. To date, no effective method has been found to completely stop the spread of the virus, and no effective cure has been discovered. Given the widespread, global nature of the coronavirus outbreak and further given that the WHO has declared this a global health emergency, generally speaking, the epidemic and governmental situation can be included under the above definition of *force majeure* in PRC law.

Judicial practice

To date, the Supreme People's Court has not issued any judicial documents regarding how to address contract disputes arising from the coronavirus outbreak. Considering that the outbreak is similar to the 2003 SARS epidemic, significant referential value may be drawn from the views of a notice of the Supreme People's Court issued in 2003 relating to the SARS epidemic, which confirmed that *force majeure* would apply where the SARS epidemic or government measures adopted against it made it impossible to perform a contract.

2. Legal consequences of a *force majeure* event

A well-drafted *force majeure* clause in a commercial contract usually provides for different consequences of a stipulated event, apart from termination of the contract, such as extending the performance deadline or amending the contract in different ways. From the perspective of contractual provisions, if the contract sets out how it should be performed after the occurrence of a *force majeure* event, the parties must follow such terms, in addition to the requirements set forth under the law.

If there is no specific agreement on the legal consequences of *force majeure* under the commercial contract, the PRC Contract Law provides the following:

- (1) Under article 117 of the PRC Contract Law, where a contract cannot be performed due to *force majeure*, liabilities shall be exempted in part or in whole in light of the effects of the *force majeure* event, unless otherwise provided by law. If the event occurs after one party has already delayed its performance, that party will not be exempted from liabilities.
- (2) Under article 94 of the PRC Contract Law, the parties to a contract may terminate it, if the purpose of the contract is rendered unachievable due to the *force majeure* event.

Accordingly, a contract can be terminated due to *force majeure* only if the *force majeure* event makes it impossible to fulfil the purpose of the contract. This threshold is rather high and, even if a *force majeure* event occurs, many contracts may not be terminated according to this stipulation.



The above provisions show that the consequences of *force majeure*, the extent of a liability exemption, and the termination of a contract depend on the specific circumstances of each case, which must be assessed individually. Even if there is a *force majeure* event, it does not necessarily lead to liability exemption or termination of contract in the specific case.

Key factors to consider include whether (i) the outbreak will inevitably lead to failure to perform the contract or the frustration of the purpose of the contract; (ii) the claiming party is also at fault; and (iii) failure to perform the contract during the outbreak results from delayed or improper performance by the claiming party.

3. Actions to invoke the application of *force majeure*

From the perspective of the contractual provisions, if the contract specifically provides for post-*force majeure* arrangements, these arrangements must be followed, in addition to relevant requirements set forth under the law.

According to article 118 of the PRC Contract Law, if either party to a contract is not able to perform it due to *force majeure*, that party shall (i) give notice to the other party in due time to reduce the losses that may be caused to the other party, and (ii) provide evidence within a reasonable time limit.

In view of the above, although the coronavirus outbreak may qualify as a *force majeure* event in general, whether the specific situation is eligible for operation of a *force majeure* rule further depends on the steps taken by the affected party seeking to invoke the clause, which shall include the following:

- (1) Notifying the event to the non-defaulting party as soon as possible and provide evidence in a reasonable time.

The notice must (i) identify the coronavirus outbreak and the scenario as *force majeure*, and (ii) state the impact on the performance of the contract (or the frustration of its purpose, thus leading to its termination).

If the contract specifically provides rules on notification, these rules must be followed

- (2) Proving that the outbreak was unforeseeable, unavoidable, and insurmountable, and that the circumstances of the outbreak rendered the party unable to duly perform the contract.

Based on the judicial practice of the PRC courts in handling similar cases during the SARS epidemic, the occurrence of a *force majeure* event should be easy to prove, as the coronavirus outbreak has been recognized as a global health emergency.



4. Changed circumstances

Whether the coronavirus outbreak or the subsequent government measures constitute a *force majeure* event and whether the defaulting party is entitled to claim remedies under *force majeure* doctrine remain arguable, depending on the specific situation of each case.

If the coronavirus outbreak or any government measures do not qualify as *force majeure* events under a particular contractual relationship, the defaulting party may still consider invoking the rule of changed circumstance (“Changed Circumstances”), which is defined under *Interpretation of the Supreme People’s Court on Several Issues Concerning the Application of the Contract Law of the People’s Republic of China (II)*, as follows:

“Where a party to a contract petitions the court to modify or rescind the contract on the grounds that the continued performance of the same is patently unfair to the party, or the purpose of the contract will not be realized due to occurrence of any material change in circumstances that was unforeseeable, not caused by *force majeure*, and not a commercial risk after the conclusion of the contract, the court shall decide whether the contract shall be modified or rescinded according to the principle of fairness on a case-by-case basis.”

A similarity exists between *force majeure* and Changed Circumstance; i.e., both must be “unforeseeable.” However, there are fundamental differences between these two obstacles to performance that do not allow them to be applicable at the same time.

For the ease of understanding, below please find a comparison chart summarizing the main differences between them:

| Factors | <i>Force majeure</i> | Changed Circumstance |
|----------------------------------|---|--|
| Seriousness of the impact | Completely prevents the performance of a contract. | Continued performance of the contract is still possible, but doing so becomes extremely difficult and obviously unfair to one party. |
| Legal consequences | Statutory exemption from liability. The affected party is exempted from liability for failure to perform, | Not a statutory exemption from liability. The parties are only entitled to claim the modification or |



| | | |
|---|---|---|
| | provided it can prove that the failure resulted from the <i>force majeure</i> event. In these cases, whether to exempt the party from liabilities is not at the court's discretion. | rescission of the contract by claiming a change in circumstances, and the court has discretion to decide whether the contract should be modified or rescinded. |
| Typical events | Natural disasters such as earthquakes, typhoons, floods, tsunamis and droughts, including social events such as war and riots. | Characterized by unexpected events such as rapid changes in the socio-economic situation, soaring prices, severe currency devaluation, financial crisis and changes in national policies. |
| Application in judicial practice | Automatically acts to relieve the defaulting party's liability. | The court can determine whether there is a change of circumstances, whether the agreement will be modified or rescinded due to that change of circumstances, and whether the affected party will be exempted from liability upon the occurrence of the change in circumstances. |

Based on the *Circular of the Supreme People's Court on Carrying out the Work of the People's Courts Related to Trials and Judgment Enforcement in Accordance with Law during the SARS Epidemic*, the coronavirus outbreak may also be deemed to constitute a Changed Circumstance:

"Where the performance of a contract in accordance with its original provisions significantly affects the rights and interests of either party to a contract due to the SARS epidemic, the disputes regarding the performance of the contract shall be dealt with according to the specific circumstances by applying the principle of fairness."



Notwithstanding the above, it should be noted that, the application of the rule of Changed Circumstance is under strict control. At all levels, the People's Court must carefully understand and apply the provisions of Changed Circumstance rule. If the application of Changed Circumstance rule is indeed necessary in a case according to the special circumstances of the case, the application should be examined by a high people's court. If necessary, the application of the above rule should be submitted to the Supreme People's Court for review.

5. Conclusions and suggestions

In our view, the coronavirus outbreak and government measures that follow it may constitute *force majeure*. However, the availability of a remedy will typically depend on the nature of the contract and how the outbreak and the specific government measures affect its performance, considering the different localities and industrial sectors.

Regarding the contract performance during the coronavirus outbreak, we advise the following:

- (1) Analyze internally any disruptions to your supply chain and check relevant contracts on a case-by-case basis.
- (2) Notify your contract partners promptly. We can assist you in preparing for this, including drafting notices to your customers and suppliers about this issue to minimize losses and other potential consequences to your business.
- (3) If necessary, contact relevant governmental authorities to apply for a *force majeure* certificate. To help businesses affected by the coronavirus outbreak and the restrictive measures imposed, on January 30, 2020, the China Council for the Promotion of International Trade ("CCPIT") announced that it would offer *force majeure* certificates to help companies deal with disputes with foreign trading partners arising from epidemic control measures.
- (4) Collect as much evidence as possible on the occurrence of the *force majeure* event, the mitigation measures adopted and the losses incurred.



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