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# COVID-19: Recent Legal Responses and the Application of Force Majeure and Change of Circumstances in the PRC

## ABSTRACT

*This article provides the readers with an update on the recent legal responses in the PRC to the COVID-19 related cases as well as a general overview on the doctrines of force majeure and change of circumstances under the PRC law. The article will begin with an introduction on Guiding Opinions (I), (II) and (III) on Several Issues Concerning Proper Handling of Civil Cases Involving the Novel Coronavirus Pneumonia Epidemic in Accordance with the Law (respectively “Guiding Opinion (I)”, “Guiding Opinion (II)” and “Guiding Opinion (III)”, together “Guiding Opinions”) recently issued by the Supreme People’s Court of the PRC (“SPC”). The article will then discuss the possible grounds for a party to seek relief from contractual obligations under the PRC law, including (i) statutory force majeure, (ii) contractual force majeure clause and (iii) doctrine of change of circumstances. The final part of the article will briefly discuss the English law position.*

## I. INTRODUCTION

Since the outbreak of COVID-19, the PRC government has implemented a series of disease control measures including delay in work resumption, lockdowns and port control. Although COVID-19 has been declared by the WHO as a “pandemic”, the situation in the PRC is under control, with progressive relaxation in the public health control measures. Most enterprises have resumed near-normal operations, and social activity is returning to normal. However, as a result of COVID-19 and the COVID-19 related response measures, there were inevitable events such as delay in production and disruptions to the supply and logistics chains which have led to a myriad of disputes in international trade and other industry sectors. As time passes, these disputes have been referred to dispute resolution institutions such as the courts and arbitral tribunals. For those matters referred to the courts, and as a matter of judicial practice, on 16 April 2020, 15 May 2020 and 8 June 2020, the SPC respectively issued the Guiding Opinion (I), the Guiding Opinion (II) and the Guiding Opinion (III) to provide guidance to all levels of the People’s Courts on how to deal with the COVID-19 related civil cases.

## II. KEY POINTS OF THE GUIDING OPINIONS

The Guiding Opinions serve to guide courts at all levels on the existing legal framework.

The Guiding Opinion (I) mainly reiterates the principles of dealing with the COVID-19 related disputes in practice, for example, it emphasises the proper application of statutory force majeure and flexible handling of different types of contractual disputes.

### **Principle on flexible handling of different types of contractual disputes**

The SPC has adopted an approach which encourages transactions and has provided guidance and opinion on the flexible handling of different types of contractual disputes. These include:

1. The statutory force majeure shall be properly applied as per COVID-19 related cases. And if the contracts cannot, in fact, be performed, the parties may exempt the liability as a consequence of force majeure.
2. For contracts where performance is rendered difficult due to COVID-19 or the COVID-19 response measures, the affected parties may first renegotiate. In principle, the contract can only be terminated if the purpose of the contract cannot be achieved.
3. The affected parties may, in consideration of the actual circumstances, petition to discharge or alter the contracts by virtue of the relevant rules under the doctrine of change of circumstances (detailed legal requirements to be discussed later). In particular, in cases where it would be manifestly unfair for one party to continue performing the contract where its performance has been materially affected due to COVID-19 or the COVID-19 response measures, the affected party can petition the court to amend or terminate the contracts. The courts will decide whether to support such petitions according to the actual circumstances.

Once the existing contracts have been ordered by the courts to be amended, the parties shall proceed with the performance of the amended contracts and any subsequent claims to exempt liabilities would be unlikely to be supported by the PRC courts. In determining the factual circumstances, such as the performance of contracts, issues of exemption of liability or the

alteration of contracts, the courts shall take into account a number of considerations, including whether the affected parties are entitled to subsidies and grants from government authorities and tax relief or exemption or autonomous debt relief by others due to COVID-19 or the COVID-19 response measures.

As a supplement to the Guiding Opinion (I), the Guiding Opinion (II) gives out more specific guidance to parties and courts involved in different types of contracts and cases such as sales contracts, house leasing contracts, financial or bankruptcy cases, etc..

The newly released Guiding Opinion (III) gives more context and discusses the foreign-related commercial and maritime cases, which at the same time puts forth practical guidance on the issues of procedural law and applicable law. Amongst others, the Guiding Opinion (III) addresses the following key points.

### **Applicable law**

If foreign-related disputes are involved, the preliminary steps are to first see whether there is any applicable international treaty or convention. If there is no such treaty or convention, the courts may apply the conflict of law principles under the PRC law to determine the applicable law.

One commonly applied international convention in China is the United Nations Convention on Contracts for the International Sale of Goods (“**CISG**”). The PRC is a CISG Contracting State but made a declaration that it shall not be bound by Article 1(b) of CISG when ratifying the convention. As such, where the PRC law is the governing law, CISG will only be applicable if both parties have a place of business in two different Contracting States, but not where only one party's place of business is in a Contracting State. In case there is a conflict between CISG and the PRC law, CISG shall be given priority. However, neither CISG cases nor international practices can be treated as authority for adjudication of disputes, but can be considered as a reference. Importantly, Article 79 of CISG is considered as a concept similar to force majeure.

If the courts conclude that a foreign law is the applicable law, the courts shall accurately understand and apply the equivalence of force majeure principles in such foreign jurisdiction but not merely apply the force majeure principles under the PRC law to such case.

### **Limitation period and other procedural issues**

The parties affected by COVID-19 may apply for an extension or suspension of the limitation period of an action. The SPC further clarifies the issues of (a) granting time extension on handing the required documents of identification and authorisations for foreign parties; (b) extending the period for submitting evidence formed outside the PRC and (c) possible extension of the period of recognising and enforcing foreign arbitration awards and judgments depending on the actual circumstances.

### **Contract of carriages, international commercial and maritime cases**

Under the PRC law, the carrier has a statutory obligation to transport the cargoes to the agreed destination via the agreed route or the customary carriage route. However, the court may not support the shipper's contention for deviation of route if the carrier has timely notified the shipper of the reasons to change the route such as due to emergency medical need or urgent quarantine measures, and provided the proof for such reasons.

In the context of shipping industry, the Guiding Opinion (III) provides guidance on practical maritime issues such as seaworthiness, cancellation of the contract by either party before the voyage, safe port issue, demurrage, liability of the freight forwarding company, delay of the ship construction, etc.. The key takeaway is to balance the parties' interest and mitigate the adverse impacts brought by COVID-19 to the shipping industry. The Guiding Opinion (III) also points out the circumstances where a carrier could legitimately terminate the contracts in accordance with Article 90 of the PRC Maritime Law if the contracts of carriages cannot be performed due to COVID-19 and the related response measures.

The Guiding Opinion (III) also covers letter of credit and guarantee disputes which often involve cross-border elements. For better handling of the foreign-related commercial cases, the SPC clarifies the application of some specific international conventions and trade customs, for example, Article 36 of UCP 600 (for letter of credit disputes) and Article 26 of URDG 758 (for guarantee disputes). In short, where such international conventions or trade customs are applicable, the courts shall follow such principles and take into account the factual circumstances to determine whether there is a force majeure. The SPC also confirms that the courts may refer to the Guiding Opinion (III) in such matters relating to Hong Kong, Macau and Taiwan.

### III. MAYOR LEGAL ISSUES IN RELATION TO THE COVID-19 RELATED DISPUTES UNDER THE PRC LAW

Broadly, COVID-19 related cases have involved the doctrines of force majeure, change of circumstances and contractual force majeure clause. Irrespective of the legal doctrine, identification of the event facts is crucial in each case and as a necessary pre-condition to the application of the relevant legal doctrine.

#### **Statutory force majeure**

Unlike English law, force majeure has a statutory basis for exemption of liabilities under the PRC law. According to Article 180 of the General Rules of the Civil Law of the PRC (“**GRCL**”), Article 117 of the Contract Law of the PRC (“**Contract Law**”) and Article 153 of the General Principles of the Civil Law of the PRC, in order for there to be a force majeure event, two thresholds must be met. The first is that the circumstances shall be unforeseeable, unavoidable and insurmountable. The second is that the force majeure event must have occurred during the performance period and there is a direct causal relationship between the event and the party’s inability to perform the contract.

#### **First Threshold**

Force majeure requires the characteristics of being “*unforeseeable, inevitable and insurmountable*”:

1. “*Unforeseeable*”: This is a “subjective” test. To determine whether an event is foreseeable, a reasonable person test is usually applied. The scope of “unforeseeable” includes not only the occurrence of the event, but also the extent of its impact. If the parties were aware of the event that may lead to the non-performance at the time of entering into the contract, the party may not be able to rely on the force majeure for exempting performance.
2. “*Unavoidable and Insurmountable*”: “*Unavoidable*” means despite the timely and reasonable measures taken by the contracting parties, the situation remained unavoidable. “*Insurmountable*” means that the difficulties caused by the force majeure event cannot be overcome even with the parties’ efforts. This means that the damage would be inevitable as a result of the force majeure event.

Following the statement by the spokesman of the Legislative Affairs of the Standing Committee of the National People’s Congress that the COVID-19 or the COVID-19 response measures could be considered as force majeure, the SPC further indicated in the Guiding Opinions that, provisions in relation to force majeure under the law should apply to COVID-19 related civil disputes provided that the relevant legal requirements are satisfied.

#### **Second Threshold**

It should be noted that in addition to meeting the conditions of unforeseeable, unavoidable and insurmountable, the affected party’s application for exemption of partial or full liability can only succeed if (a) such force majeure event occurred within the contractual performance period (see Article 117 of the Contract Law) and (b) there was a direct causal relationship between the force majeure event and an inability to perform civil obligations (see Article 117 of the Contract Law and Article 180 of the GRCL). It must also be noted that, under Articles 118 of the Contract Law, the affected party bears a statutory obligation to provide timely notification to its counterparty together with proof within a reasonable period of time.

There are possible legal consequences following a finding of statutory force majeure:

1. The affected party shall be exempted from its respective legal liabilities;
2. The PRC law provides that, where the purpose of a contract has been frustrated due to force majeure, the relevant concerning party shall then be entitled to terminate the contract (Article 94 of the Contract Law); and
3. In practice, the PRC courts may allow the affected party to defer performance of the contract or partially perform the contract or amendment of the contract.

Whether COVID-19 or the COVID-19 response measures can satisfy the requirements of force majeure under the PRC law will depend on the relevant factual circumstances. Given the complexity of the legal issues, parties are recommended to obtain legal advice in each instance.

As a remark, we note that the legal position of force majeure in other civil law systems is similar to that in the PRC. For example, under the French law, the force majeure is codified in the French Civil Code and is defined as “*an event beyond the control of the debtor, which could not have reasonably been foreseen at the time of the conclusion of the contract and whose effects cannot be avoided by appropriate measures, preventing performance of its obligation by the debtor*”, which is similar to the concepts of “*unforeseeable, inevitable and insurmountable*” under the PRC law.

### **Contractual force majeure clause**

As aforementioned, the affected party may be exempted from its liability by virtue of statutory force majeure under the PRC law without the need to reach any contractual agreements. In practice, it is more often that the contracts will include a force majeure clause. According to the PRC law, the possible scenarios relating to the contractual force majeure clause are as follows:

1. The force majeure clauses should not affect the application of statutory force majeure, meaning that any force majeure clause excluding the applicability of statutory force majeure shall be invalid;
2. If the scope of force majeure events stipulated in the force majeure clause objectively satisfies the three conditions (unforeseeable, unavoidable and insurmountable), the court will usually recognise such force majeure events and manage the case in accordance with the law;
3. However, if one or more events stipulated in the “force majeure clause” is not in compliance with the three abovementioned conditions, the so-called “force majeure clause” will be considered as equivalent to something akin to an exemption clause, a “contractually agreed termination clause” or simply a contractual term agreed by the parties. Nonetheless, through the recognised principle of autonomy, any such clause is likely to be valid unless it is in breach of the PRC law.

Therefore, if the affected party has clearly agreed in the force majeure clause that the force majeure events include “infectious diseases” or “epidemic”, this may be a valid basis for seeking an exemption of liability by the affected party. On the other hand, even where the contract does not contain such force majeure clause, the parties may still be able to rely on the statutory force majeure to seek relief.

### **Doctrine of change of circumstance**

Under the PRC law, in the case where an intervening event does not qualify as a force majeure event, a concerned party may still consider the doctrine of change of circumstances to protect their position. The doctrine of change of circumstances is provided in Article 26 of Interpretation II of the Supreme People’s Court of Several Issues Concerning the Application of the Contract Law of the People’s Republic of China, which reads “*where any significant change in the objective environment has taken place after the formation of a contract which could not have been foreseen by the relevant parties at the time of entering into the contract, and does not belong to any commercial risk occasioned by any force majeure cause, rendering the continual performance of the contract manifestly unfair to the relevant party or rendering it impossible to realise the goal of the contract, the People’s Court shall confirm whether the contract shall be varied or dissolved in accordance with the principle of justice taking into account the actual circumstance, where a relevant party petitions a People’s Court to vary or dissolve the contract.*”

However, it should be noted that, unlike the legal requirements for establishing statutory force majeure under the PRC law, there is no statutory provision which allows a party to modify or terminate a contract by invoking the doctrine of change of circumstances. A concerned party would have to petition to the courts or arbitral tribunals for relief, but under this doctrine liability may not be fully or partially exempted. According to the provisions of “Notice of the Supreme People’s Court on Correctly Applying the Interpretation II of Several Issues concerning the Contract Law of the People’s Republic of China So As to Serve the Primary Objectives of the Party and the State”, when the courts seek to apply the doctrine of change of circumstance, they may need to seek review and approval from a higher level of courts and, if necessary the SPC, on a case-by-case basis. In practice, the PRC courts usually hold a strict view in applying the doctrine of change of circumstances which means that it can be difficult for a party to succeed on an application for relief based on change of circumstances.

It is noteworthy to mention that the doctrine of change of circumstances regime will largely be codified by the new Civil Code of the PRC, which will come into force on 1 January 2021.

### **Recent COVID-19 related cases in the PRC**

The Lichuan County People’s Court of Jiangxi Province has recently concluded a COVID-19 related case, which was a dispute over leasing contracts. According to the report from the Higher People’s Court of Jiangxi, the Lichuan County People’s Court was of the view that the outbreak of COVID-19 constituted force majeure and led to the party’s failure to perform the contract. The affected party could therefore be wholly or partially exempted from its liabilities. Moreover, the court further considered that the tenant and the landlord shall, according to the principle of fairness, share loss due to

suspension of operation as a result of the government orders. The landlord shall therefore appropriately reduce and exempt the rent. Although the case was tried before the issuance of the Guiding Opinions, the judgement appears to be in accordance with their spirit.

Another similar case before the People's Court of Huangpu District of Shanghai involved the leasing of a hotel room for a hotel accommodation business. As a result of COVID-19 and its response measures, the plaintiff suspended the business at the request of the government. The plaintiff was of the view that the purpose of the leasing contract could not be achieved, and asked for a refund of part of the rent, deposit and other issues. The parties reached a settlement with the assistance of the court.

#### IV. OBSERVATIONS ON ENGLISH LAW

For contracts governed by English law, the doctrines of force majeure and frustration may, in certain circumstances, be invoked by a party to suspend, delay or discharge contractual obligations.

##### **Force Majeure**

Unlike the PRC law, the term "force majeure" has no established meaning under English law and the parties have to expressly set this out in the contract. The contract may state, for example, "*force majeure excepted*" without more. Or as is more common, it may name events that constitute force majeure events, and may further include a general catch-all provision covering all and any events beyond a party's reasonable control.

Some clauses include force majeure events such as "*epidemic or pandemic*" and "*any law or any action taken by a government or public authority*". Both phrases have a direct bearing in the context of COVID-19. Regarding "*any law or any action taken by a government or public authority*", one example is the General Office of the People's Government of Zhejiang Province of the PRC, which issued a notice on 27 January 2020, to postpone the resumption of work and school in the province. The issuance of governmental notices of this kind may be classified as the "*requirements of governmental authorities*". Again, much will depend on the factual circumstances as well as the phrasing and interpretation of the particular clause.

In summary, the effect of a force majeure clause depends on the specific wording of the clause. Some force majeure clauses operate to suspend or extend performance until the relevant force majeure event has come to an end, while others operate to bring the contract to a complete end. A force majeure clause will commonly include provisions regarding notices, timings and other specific requirements, which are required to be met should a force majeure event occur. If a party wishes to invoke the clause, it is important that the specific requirements of the clause are adhered to.

##### **Frustration**

Under English law, a contract may be frustrated when an event occurs that is both unexpected and beyond the control of the contracting parties, and renders it physically or commercially impossible to fulfil the contract, or transforms the obligation to perform into a radically different obligation from that undertaken at the moment of entry into the contract.

Accordingly, if a contract does not include a force majeure clause, the parties may be able to invoke the doctrine of frustration, which may result in the parties being excused from performance and effectively result in the termination of the contract. Whether a contract is frustrated due to COVID-19 will depend on the particular factual circumstances of a case at the time frustration is sought to be invoked by a party, as well as by the nature and scope of the underlying contract.

It must be noted, however, that frustration is generally difficult to establish under English law.

#### V. CONCLUSION

It is reasonably expected that cases which have COVID-19, or the response to COVID-19, as a factual component to the legal cause of action will continue for the foreseeable future. While the applicable PRC or English law is comparatively simple to recite, the facts and their application to the law may be complex and arguably unique in each instance. It follows that parties at risk of performance due to COVID-19 or COVID-19 response measures are recommended to obtain prompt legal advice.

**\*Disclaimer: the purpose of this article is to provide information on, and developments in, the law. It does not contain a full analysis of the law and does not constitute an opinion of Reed Smith Richards Butler on the points of law discussed. You must take specific legal advice on any particular matter which concerns you.**

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