Force Majeure under Chinese law and How It May Apply to U.S. Business Interests

3.3.2020

The outbreak of Covid-19 ("coronavirus") in China has interrupted global supply chains. Factory lockdowns, labor quarantines, and transportation suspensions are impacting downstream commerce. In many cases, force majeure provisions in supply contracts do not state whether such an epidemic is a force majeure. At present, the Chinese legislature and courts have provided no guidance on whether the coronavirus is a force majeure, but there is statutory Chinese law and precedent. Chinese statutory law provides in the Contract Law of China[1]:

Section 117: Force Majeure

A party who was unable to perform a contract due to force majeure is exempted from liability in part or in whole in light of the impact of the event of force majeure, except otherwise provided by law. Where an event of force majeure occurred after the party's delay in performance, it is not exempted from liability.

For purposes of this Law, force majeure means any objective circumstance which is unforeseeable, unavoidable and insurmountable.

Section 118: Duty to Notify in Case of Force Majeure

If a party is unable to perform a contract due to force majeure, it shall timely notify the other party so as to mitigate the loss that may be caused to the other party, and shall provide proof of force majeure within a reasonable time.

In 2003, after the SARS, virus outbreak in China, the China Supreme Court issued a formal interpretation[2] that:

Contract disputes caused by the administrative measures taken by the government agencies to prevent the SARS epidemic, or

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directly due to the impact of the SARS epidemic, which caused the parties to fail to perform, shall be resolved in accordance with Section 117 and 118 of the "Contract Law of China."

In addition, as to whether the 2003 SARS epidemic constitutes an objective circumstance which is "unforeseeable, unavoidable and insurmountable", the Second Circuit Court of Beijing[3], stated that:

"SARS, as an emergency of public health, with its worldwide outbreak, is not only unforeseeable by the parties concerned, but also unforeseeable by public health experts who have extensive medical knowledge. Since its outbreak, there has been no effective method to prevent its spread, and even no definite source of infection has been determined. Although many SARS virus infected have recovered and discharged from hospital after treatment, the medical experts have not yet developed a definite and effective treatment method. Therefore, this public health emergency, at least at present, is an objective circumstance that human beings cannot foresee, avoid and overcome. It is, by nature, a force majeure that falls into its definition by law."

The standards of "timely notify" and efforts to "mitigate the loss" are not clear legal standards under the statute or Chinese court rulings. The SARS epidemic broke out in 2003, and Chinese companies were not playing as active roles as today in the global supply chain, so the precedents are mostly landlord-tenant disputes and employment cases. In those cases, Chinese courts evaluated the facts and determined if a force majeure notice was given "reasonably timely" and mitigation methods had been sought based on good faith, and were "reasonable under the circumstances." Because of the lack of adequate Chinese legal precedent, affected companies should provide notices within the time periods, and with the substance, required by their specific contract force majeure clauses and the law CISG and U.S. law as guidelines.

As noted above, there has not been a formal interpretation or guidance as to the coronavirus. A formal interpretation, if any is to be issued, may not be issued soon. The SARS interpretation was not issued until after the SARS outbreak subsided. In addition, at the current time, the judicial register or schedule has been placed on a posted delay because of the concern of the courts for the spread of the disease. Based on these factors, it is likely that the Chinese courts will list the coronavirus epidemic to be a force majeure, but it may take time for the courts to act. However, China Council for The Promotion of International Trade (CCPIT), officially accredited with Beijing's Ministry of Commerce, has already granted over 1,600 certificates of force majeure to Chinese companies. The weight of such a certification outside of China is not certain.

But, why should American companies be concerned about Chinese law? Although many American based buyers purchase under terms and conditions adopting U.S. or other non-Chinese laws, Chinese subsidiaries purchasing from Chinese subsidiaries may be operating under contracts governed by Chinese law as may be U.S. suppliers of Chinese OEMs. The following provides some guidance in such situations.

- **The Agreement Adopts Chinese law**

- If Chinese law is adopted by the agreement, the agreement is generally indisputably governed by Chinese law. Thus, Section 117 and 118 of the "Contract Law of China" as well as any further interpretations published by Chinese courts shall apply.

- **No Adoption of any Law, but the Contract is Between Two Chinese Companies**
  - If no specific law is adopted by the agreement, and the agreement is between two Chinese companies (including subsidiaries of multinational companies operating in China), Chinese courts should have both personal jurisdiction and subject matter jurisdiction over the parties. Therefore, the agreement is governed by Chinese law, and Section 117 and 118 of the "Contract Law of China" as well as any further interpretations published by Chinese courts shall apply.
- **No Adoption of any Law, between a Chinese company and a non-Chinese Company**
  - China is a signatory of United Nations Convention on Contracts for the International Sale of Goods ("CISG"). If the non-Chinese party of a supply agreement is also from a signatory country, the CISG will be the governing law. Article 79 of CISG[4] states:
  - (1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.
  - (4) The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt.
- **Non-Chinese law is adopted in an agreement with or without a force majeure clause, that may conflict with Chinese Law**
  - If the choice of law clause in a supply contract stipulates that non-Chinese law (such as U.S. or European law) governs the contract, and the coronavirus epidemic is not listed as a force majeure event in the contract or recognized under the foreign law. A Chinese court may not enforce a foreign judgment or arbitration awards in China. In the Chinese supplier may petition the Chinese court for non-enforcement of a foreign arbitration award or a ruling of a foreign court, based on Sections 4 and 5 of "Act of Foreign Laws Application in Civil Disputes in China"[5] ("AFA")

Sections 4 of AFA states that "if the laws of the People's Republic of China have mandatory provisions on applying certain Chinese laws on such civil disputes, Chinese laws shall apply." Section 5 provides that Chinese law shall be applied to protect certain interests, and the non-Chinese law shall not apply in such a scenario.

China Supreme Court has clarified that in what scenarios the AFA shall apply[6]. "In one of the following scenarios, which involves the public and public interests of the People's Republic of China, the parties cannot stipulate the governing law by agreement, and a tribunal can apply, regardless of rules of conflict of laws, laws of China according to the mandatory provisions in Section 4: (1) those

involving the protection of workers' rights and interests; (2) those involving food safety or public health; (3) those involving environmental safety; (4) those involving financial security such as foreign exchange control (5) involving antitrust and anti-dumping; (6) situations that the court finds appropriate. "

Presumably, for interruptions caused by the coronavirus outbreak, Chinese suppliers would claim that because they were forced to delay delivery to protect workers' rights, food or public health safety, or environmental safety, their failure to perform is excused without liability. Thus Chinese suppliers may be able to move to avoid enforcement of a judgment or award based on the application of non-Chinese laws.

In addition, Sections 5 of AFA states that "if the application of foreign laws would harm the social and public interests of the People's Republic of China, the laws of the People's Republic of China shall apply. " The concept of "social public interest" is found in decisions on the non-recognition and non-enforcement of foreign arbitration awards, or foreign court decisions. However, recognition and enforcement of foreign arbitration awards is an obligation required by international treaties that China is a signatory. Therefore, the Supreme People's Court and local courts have been reluctant to use "social and public interests" to invalidate foreign arbitral awards in commercial cases. This is not to say that recognition of foreign court judgments is easy in China.

For further information, please contact the authors of this Alert. Please also see a Chinese language version of this Alert below.

Also, please join us for a complimentary webinar on Wednesday, March 4 at 12:00 pm EST covering the Coronavirus and Force Majeure correlation. Register here.

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(Translation in Chinese Language)

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[1] *Contract Law of China*, March 15, 1999 (https://www.wipo.int/edocs/lexdocs/laws/en/cn/cn137en.pdf)

[2] *Notice on Related Trial and Enforcement during the Prevention and Treatment of SARS Epidemic* (CLI.3.49481, June 11, 2003, expired, for comparative analysis only) (http://pkulaw.cn/%28S%28pvgj1x45wuwnwm5555df4e55%29%29/fulltext_form.aspx?Gid=49481&Db=chl&EncodingName=big5)

[3] *Correctly Apply Laws to Cases Where the SARS Epidemic Constitutes an Excusable Force Majeure* (CLI.A.1112295, Application of Laws, Issue 6, 2003) (https://www.pkulaw.com/qikan/fab69afe39235f5f62555561d299c0f6bdfb.html)

[4] *ANNOTATED TEXT OF CISG Article 79* (http://www.cisg.law.pace.edu/cisg/text/e-text-79.html)

[5] *Act of Foreign Laws Application in Civil Disputes in China* (Issued on Oct. 28, 2010 by President Hu, effected on April. 1, 2011) (http://www.gov.cn/flfg/2010-10/28/content_1732970.htm)

[6] *Interpretation (1) of the Supreme Court on Several Issues Concerning the Application of the Law of China in Civil Relations*, released on Dec. 28, 2012, in effect on Jan. 7, 2013, China Supreme Court (https://www.chinacourt.org/law/detail/2012/12/id/146055.shtml)