

Force Majeure In The Time Of Coronavirus

With no end in sight to the outbreak, companies may want to consider this legal option to mitigate the impact of the crisis on their business.

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COVID-19, commonly known as coronavirus, is causing an epidemic of respiratory illness in more than 60 countries. With the mandatory quarantines and the closure of many businesses, including manufacturing facilities and suppliers, the impact on the supply chains and operations will be enormous in the short term. With no end to the coronavirus outbreak in sight, companies may want to consider force majeure as a legal option to mitigate the impact of the crisis on their business.

What is force majeure?

Force majeure refers, as most readers here know, to a legal doctrine under which a party may be relieved from liability for non-performance when “acts of God,” such as floods, earthquakes, tsunamis, drought, government restrictions or other extraordinary circumstances beyond the party’s control prevent fulfillment of contractual obligations.

A typical force majeure clause will require that the disruption of performance be beyond the invoking party’s reasonable control and that the event was not reasonably foreseeable. A force majeure clause usually lists several categories of events that could impact suppliers and customers across the supply chain, steps that the party invoking force

majeure must take, as well as the legal consequences in the event of a force majeure event. While most force majeure provisions are unlikely to list disease, epidemics, or quarantine specifically, many include general provisions covering such things as natural disasters, “acts of God,” acts of government or “other circumstances beyond the parties’ control.”

Force majeure doctrine may also come into play as a matter of law; obligations can either be governed by contract provisions (force majeure clauses) or, in their absence, under the applicable domestic law, international treaties or common law contract doctrines.

Applicability of force majeure doctrine under statute or contract

The jurisdiction and the choice of law issue is extremely important in the international trade setting as the question of whether a particular situation falls within the scope of force majeure and its impact may depend on which law applies. For example, if a particular transaction is governed under the U.S. law and the force majeure clause does not expressly provide that epidemic disease as force majeure, the affected party may not be able to invoke the coronavirus outbreak as force majeure or involve the commercial impracticability doctrine to seek exemption from liabilities. However, if a particular transaction is governed under Chinese law, even if the force majeure clause limits force majeure to only certain listed events not including epidemic disease, the epidemic disease may nevertheless constitute force majeure by operation of the statute.

Force majeure under the U.S. law

In the U.S., force majeure is largely a creature of contract. Thus, whether an event of force majeure has, in fact, occurred, the parties’ obligations in the event of force majeure largely depends on the contract rather than law. As a consequence, an explicit force majeure clause is required to relieve parties of contractual obligations.

In the event a contract lacks a force majeure provision, then the parties may seek protection under the common law doctrines of impossibility of performance, commercial impracticability or frustration of purpose.

- Impossibility doctrine requires literal impossibility to excuse a party's performance
- Commercial impracticability doctrine excuses performance where (1) an event renders performance impracticable, (2) its non-occurrence was a basic assumption of the contract, and (3) the risk of the event is not allocated by custom or contract.
- The doctrine of frustration of purpose, on the other hand, applies where a supervening event fundamentally changes the nature of a contract and makes one party's performance worthless to the other.

Force majeure under Chinese law

China has statutes expressly defining force majeure as “any objective circumstances which are unforeseeable, unavoidable and insurmountable.” Article 180 of Civil Code states, “the failure to perform the contract due to force majeure or cause damage to others shall not bear civil liability.” Article 117 of the Contract Law further provides that “[a] party who is 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 occurs after the party's delay in performance, it is not exempted from such liability...If a party is unable to perform a contract due to an event of force majeure, it shall timely notify the other party so as to mitigate the losses that may be caused to the other party, and shall provide evidence of such event of force majeure within a reasonable period.”

Force majeure under UN Contracts for the International Sale of Goods (CISG)

The United Nations Convention on CISG does not use the term “force majeure,” but has adopted the force majeure doctrine implicitly. In their books, a party is exempt from liability for a failure to perform any of its obligations if it proves that:

1. the failure was due to an impediment beyond its control
2. that the party could not reasonably be expected to have taken the impediment into account at the time of the contract or to have avoided or overcome it

The CISG also imposes notice requirements, mandating that the party affected must give notice to the other party of the impediment and its effect on his ability to perform within a reasonable time.

Could the coronavirus outbreak qualify as a force majeure event?

The coronavirus outbreak presents a somewhat unique situation in that it contains both a naturally occurring component, the virus itself, and a government action component, such as the quarantines put in place in

response to the outbreak. There is no simple answer to whether the coronavirus would qualify as a force majeure event, as it depends on each particular transaction, their contracts and governing laws.

The coronavirus is a completely new, severe, sometimes fatal illness and has quickly reached epidemic status. The outbreak in China is the first time this coronavirus affected human beings, so the occurrence could be considered unforeseeable, unavoidable and insurmountable under the Chinese law.

The Chinese government additionally has taken various measures to prevent the further spreading of the virus. A Feb. 10 press release from the National People's Congress stated that "[f]or the parties who are therefore unable to perform the contract, it is an unforeseeable, unavoidable and insurmountable force majeure. According to the relevant provisions of the Contract Law, if the contract cannot be performed due to force majeure, partial or total liability shall be exempted from liability according to the impact of force majeure, unless otherwise provided by law." In other words, to the extent that a party can demonstrate the failure to perform was due to the coronavirus, transactions governed by Chinese law are likely to be treated as force majeure, thereby releasing parties from liability.

However, the coronavirus outbreak may not automatically qualify as a force majeure event under the U.S. law, since force majeure is treated as a creature of contract rather than law. It all depends upon how broadly the force majeure concept is defined under the contract. Many force majeure clauses are very broad and simply require that the event is one beyond a party's control. Provided that the conditions in a force majeure clause are satisfied and it can be demonstrated that the outbreak has affected the parties' ability to fulfill their contractual obligations, then the coronavirus outbreak may well meet the contractual requirement and be considered a force majeure event.

Practical Guidance and Considerations

Obtain CCPIT's force majeure certificate

To help reduce damages of affected companies and to safeguard their rights and interests, the China Council for the Promotion of International Trade (CCPIT) is offering "force majeure certificates." This kind of certificate is a common practice in international trade and it confirms the facts related to force majeure, but does not determine whether the occurrence of the facts themselves constitute a force majeure event under

any particular contract. To apply for the force majeure certificate, companies must submit:

1. certificate or announcement issued by the government or agency where the company is located
2. notice or certificate of transportation-related delays and cancellation
3. export cargo sales contract, cargo booking agreement, freight agency agreement, customs declaration, etc.
4. other available materials

Provide notice as soon as practically possible

“Force majeure notice” or “commercial impracticability notice,” is generally required to trigger force majeure protection under force majeure clause or under the statute. While there is no legal requirement for such notice to bear any particular name or be in any particular form, the notice must generally include information on the occurrence of the coronavirus outbreak in a certain location, the impact on the business, inform the buyer that there will be delay or non-delivery, and, when allocation is required, a statement of the estimated quota to be made available for the buyer so the party receiving the notice is aware of what happened and can begin to seek measures to mitigate the damages. Such notice should be given immediately when it first becomes practically possible.

Respond to the notice

It is important that the party receiving the notice realizes that such a notice cannot be ignored. The individual receiving the notice should immediately forward the notice and any correspondence associated with it to their management and its legal department and closely analyze and respond immediately to preserve its rights. If complete information is not available, the party providing the notice should supplement its notice as additional information becomes available. Assuming that the party receiving the notice decides to accept that a force majeure event has occurred, the party receiving the notice needs to decide whether to terminate the contract entirely, or to modify the original contract and accept partial performance within a reasonable time, typically no more than 30 days after receiving the notice. The party receiving the notice should additionally actively seek alternative suppliers in order to mitigate its damages during the time period.

Preserve all evidence related to the force majeure event

It is extremely important for the affected party keep all documents related to the force majeure event, such as national, provincial and local government regulations, rules, notices and guidelines; news related to the

coronavirus outbreak, quarantines, restricted travel and mandatory shutdown of airports, train stations, sea ports, factories, city or even province, particularly related a certain location or industry; any notice or certificate of sea, land and air-related delays and cancellations; any cargo sales contract, cargo booking agreement, freight agency agreement, customs declaration; notices provided to the employees and customers related to a factory shutdown, late delivery or non-delivery, change of demand, cancellation of contract; any cancelled flight or train tickets or anything related to the travel itinerary; any road or factory shut down; any cancelled visa or permit, denied visa applications; or any other documents related to the coronavirus outbreak and the ability to perform the contract in whole or in part. For individuals who were subject to quarantines, it would also be important to keep all quarantine and health care documents.

Mitigate damages

It is likely that both contract parties have the duty to mitigate damages in the event of force majeure. Thus, it is important for the parties to work together to assess inventory on hand, to determine whether there is a bank of parts that can be accessed, to identify other manufacturing lines available at different locations, to assess the affected supplier's allocation plan, as well as to consider whether and when an alternative supplier can be obtained. The affected parties should look across the company's supply chain to identify facilities potentially impacted by the coronavirus and to consider contingency plans. The receiving party should evaluate whether that notice triggers a force majeure event for the company, requiring issuance of notice to its own customers. Each affected party should additionally submit insurance claims immediately and work with its insurance adjustors to handle the claims.

Prepared for Possible Dispute

While parties may wish to resolve a dispute amicably among themselves, the adverse impact of coronavirus outbreak may require a judge or tribunal to help make the decision. It is highly likely that disputes related to the coronavirus outbreak will occur in large numbers. For that reason, parties should start to collect evidence and be prepared for possible litigation or arbitration.