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Force majeure – Legal impact of recent coronavirus outbreak on international trade

COVID-19, a new virus commonly known as coronavirus, that is causing an outbreak of respiratory illness, has now become a serious disease detected in more than 60 countries. First identified in early December 2019 in the city of Wuhan, Hubei Province, China, the coronavirus quickly spread across the globe. On Jan. 27, 2020, the U.S. Centers for Disease Control and Prevention (CDC) raised its travel warning for China to Level 3 – the highest level – warning travelers to avoid nonessential travel to the country. On Jan. 30, 2020, the World Health Organization declared a global emergency over the deadly coronavirus outbreak, after China reported its biggest single-day jump in the death toll and there was an increase in the number of confirmed coronavirus cases in many countries across the globe. As of March 4, 2020, the National Health and Care Commission for the People's Republic of China confirmed 80,566 cases, 3,015 deaths and 522 suspected cases within China related to the virus. In addition, there are now over 14,614 confirmed cases globally outside of China, including:

- 5,766 in South Korea
- 3,089 in Italy
- 2,922 in Iran
- 331 in Japan
- 112 in Singapore
- 153 in the United States

On Feb. 25, 2020, the CDC issued an official statement warning that Americans should prepare for the spread of the coronavirus in communities across the country, stating that "it is not so much a question of if this will

happen anymore, but rather more a question of exactly when this will happen and how many people in this country will have severe illness." The CDC additionally raised its travel warning for South Korea to Level 3, urging travelers to avoid all nonessential travel to South Korea.

In an effort to slow the spread of the virus, Chinese authorities are imposing quarantines and restricting travel throughout the country. Chinese officials have closed numerous public transportation options within, into and out of Wuhan and other cities in Hubei province. Many cities and provinces within China have implemented similar closures. All ports in Hubei province, a major Chinese steelmaking hub, have been closed, hampering both iron ore imports and steel exports. Hong Kong has closed some of its borders with mainland China and has stopped issuing travel permits to mainland Chinese tourists. Mongolia and Russia (far east border) have closed their respective borders with China as well. Singapore has stopped issuing visas to Chinese citizens. Key international airlines have suspended or reduced flights due to the outbreak, and some have suspended all flights from/to China entirely.

There is an extreme shortage of supplies and limited access to adequate medical care in affected areas. Many countries are taking measures to move their respective citizens out of China.

The rapid spread of the outbreak across the globe has raised concerns for those who have operations in China and internationally, particularly in the manufacturing industry and in the oil and gas industry. Given the much-anticipated U.S. and China trade agreement signed in January, the outbreak will likely have a tremendous impact on global trade, such as the possible bankruptcy of manufacturers, disruption of the manufacturing and supply chain, an increase of insurance claims and a possible significant decrease of demand. With mandatory quarantines and the closure of many businesses, including many manufacturing facilities and suppliers, the impact on the supply chain and potential operation disruptions will be enormous in the short term. The coronavirus outbreak has roiled global commodity markets. Refiners in China are poised to slash crude imports and throughput over the coming months. Industry experts and market analysts have recently revised down their forecasts for China's throughput in February and March by 600,000 - 1 million barrels per day, with crude imports set to slow down accordingly in April and May. A Chinese government economist has forecast that the country's economic growth rate may drop to 5 percent, or even lower, from 6.1 percent in 2019. The stock market has plummeted internationally as fear over the coronavirus continues to spread.

With no end to the coronavirus outbreak in sight, companies should carefully analyze the potential impact of the crisis and explore possible options. For example, companies should review their supply chain and manufacturing footprint to assess whether they are at risk of having their operations disrupted. Affected or potentially affected companies should take proactive steps to mitigate their risk and prepare for how they will

address any shortage of supplies, increase in price for certain products, decrease of demand or price for some other products and the interruptions of their operations. Force majeure has naturally been at the forefront for businesses assessing their individual legal options.

What is force majeure?

Force majeure is a civil law concept (French for "superior force"). It refers 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 the party from fulfilling its obligations under a contract. The force majeure doctrine may come into play as a matter of law or as a matter of contract. The domestic laws in many countries, such as France, Germany, Japan and China, as well as many international treaties, contain provisions on force majeure. The performance obligations of companies affected by an extraordinary event will be governed under either applicable contract provisions (force majeure clauses) or, in their absence, under applicable domestic law, international treaties, or common law contract doctrines such as impossibility and commercial impracticability.

Force majeure clauses

Force majeure clauses are widely seen in business contracts. Such provisions can vary greatly depending on how they were drafted by the parties. 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 covers several categories of events that could impact suppliers and customers across the supply chain. Many of these provisions include a list of specific events that may be considered a force majeure event under the contract. 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."

A well-drafted force majeure clause often will include specific steps that the party invoking force majeure must take. In most circumstances, such a clause would typically require the affected party to provide notice within a certain number of days or within a reasonable time period and would specify the content of such notice. Such clause would additionally require the parties to exercise "good faith" or "best efforts" or commercially reasonable efforts to preserve the ability to perform, as well as to mitigate damages. The clause may even provide a specific action plan for ameliorating the disruption. For example, the clause may require a seller to pay for a more expensive source of supply than originally contemplated. It may also require, in the case of limited supply, an allocation of available product among customers.

The force majeure clause typically also governs the legal consequences in the event of a force majeure event. Typically, such a clause exempts the affected party from liability for any non- performance or delayed performance of certain obligations. The other party is also provided with the option to either terminate or modify the contract. However, a force majeure clause may not necessarily excuse the affected party from all performance. For instance, if the event only makes performance more difficult or expensive, it will not necessarily excuse non-performance. Performance is usually not suspended unless the disruption lasts for a specified period of time.

Applicability of force majeure doctrine under statute or contract

Force majeure under 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 and whether the occurrence of force majeure exempts the parties from certain obligations or entitles the parties' ability to terminate the contract largely depends on the contract provision. As a consequence, an "act of God" does not relieve the parties of their contractual obligations absent an applicable force majeure clause. *GT&MC, Inc. v. Texas City Refining, Inc.* Courts apply the usual rules of contract construction in interpreting force majeure provisions. *Virginia Power En. Mktg. v. Apache Corp.*, ("The scope and effect of a 'force majeure clause' depends on the specific contract language and not on any traditional definition of the term.")

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. The doctrine of impossibility can be traced to *Taylor v. Caldwell*, where the owner of a music hall was excused of liability for failing to make the hall available due to an accidental fire that destroyed the building. Under the impossibility doctrine, literal impossibility is required to excuse a party's performance. Under the commercial impracticability doctrine, contractual performance is excused where:

- an event renders performance impracticable
- its non-occurrence was a basic assumption of the contract
- the risk of the event is not allocated by custom or contract

The doctrine of frustration of purpose, on the other hand, focuses on the parties' purpose in making their contract and has nothing to do with a party's inability to perform. It applies where a supervening event fundamentally changes the nature of a contract and makes one party's performance worthless to the other. *Wall v. Altium Grp.* However, it is very important to recognize that if the parties include a force majeure clause in the contract, the clause typically supersedes the impossibility, commercial impracticability or frustration of purpose doctrines. *Commonwealth Edison Co. v. Allied-General Nuclear Services* "[L]ike most contract doctrines, the

doctrine of impossibility is an 'off-the-rack' provision that governs only if the parties have not drafted a specific assignment of the risk otherwise assigned by the provision."

In a case involving the sale of goods, Section 2-615 of the Uniform Commercial Code (UCC) provides a defense similar to commercial impracticability. Under the UCC, late delivery and non-delivery is exempt in whole or in part "if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid." When the ability to perform is affected partially, the UCC mandates the seller to allocate production and deliveries among its customers fairly and reasonably, but the seller may include regular customers not then under contract as well as its own requirements for further manufacture. The UCC further mandates the seller to notify the buyer seasonably that there will be a delay or non-delivery, and, when allocation is required, a statement of the estimated quota to be made available for the buyer. A seller's notice triggers a limited set of options for the buyer and requires that the buyer take action within a limited period of time, not to exceed 30 days. The buyer receiving the notice has the option to either (a) terminate the contract entirely and discharge the affected party from liability or (b) modify the contract by agreeing to take its available quota in substitution, but the UCC does not provide the buyer with other options. If, after receipt of such notification from the seller, the buyer fails to modify the contract within a reasonable time, not exceeding 30 days, the contract lapses with respect to any deliveries affected. The UCC does not define "lapse." When the contract lapses under Section 2-616(2) of the UCC, while the seller is excused of obligations to the extent of the deliveries affected, it is unclear whether the original contract will stay in place and whether the seller's obligation to sell (and the buyer's obligation to buy) will come back into existence once the force majeure abates. This can create inconvenient circumstances if the buyer contracts with another supplier for the affected goods. It is possible that the original supplier could reappear and expect the buyer to honor the purchase commitment in the original contract for the unaffected quantities. Where possible, the buyer should reach express agreement with the original seller about whether, and to what extent, the original supply relationship will resume after commercial impracticability passes.

Force majeure under Chinese law

China has statutes expressly providing what is force majeure and its legal implications. Article 180 of General Provisions of the Civil Law of the People's Republic of China (China Civil Code), Article 153 of the General Principles of the Civil Law of the People's Republic of China (replaced by Article 180 of the China Civil Code) and Article 117 of the Contract Law of the People's Republic of China (Chinese Contract Law) all define force majeure as "any objective circumstances which are unforeseeable,

unavoidable and insurmountable." According to Article 180 of the China Civil Code and Article 107 of the General Principles of the Civil Law of the People's Republic of China, "the failure to perform the contract due to force majeure or causing damage to others shall not bear civil liability." Article 117 of the Contract Law of the People's Republic of China 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."

While the China Civil Code or Contract Law does not expressly provide whether epidemic disease constitutes force majeure, some ministerial documents, such as the Application Guidance by the Ministry of Water Resources On Rural Hydropower Automation Equipment (Monitoring and Protection), expressly list epidemic outbreak as a force majeure. The Notice of the Supreme People's Court on the Conduct of Relevant Trials and Implementation by the People's Court in Accordance with the Law During the Prevention and Treatment of Infectious Atypical Pneumonia (Infectious Atypical Pneumonia Notice) issued by the Supreme People's Court in 2003 provides important guidance on how the coronavirus outbreak will likely be handled under Chinese law. Article 3 of the Infectious Atypical Pneumonia Notice provides that "[d]isputes arising from any non-performance as a result of any administrative measures taken by the government and relevant departments to prevent and control SARS outbreak, or cause the parties to the contract simply not to perform due to the impact of the SARS epidemic, shall be properly handled in accordance with the provisions of Articles 117 and 118 of the Contract Law of the People's Republic of China." In other words, any disputes arising from the infectious atypical pneumonia outbreak in 2003, whether caused by the natural disease itself or the government's reaction as a result of the natural disease, were treated as force majeure. The party who is unable to perform a contract due to force majeure is exempted from liability in part or in whole under the Chinese law.

Although the Supreme People's Court has not yet issued any similar notice related to the recent coronavirus outbreak, a spokesperson for the Standing Committee for the National People's Congress, Mr. Tiewei Zhai, has stated in a press release on Feb. 10, 2020, that "[a]t present, there has been a new coronary pneumonia outbreak in China, a public health emergency. In order to protect public health, the government has also taken corresponding measures to prevent and control the outbreak. For 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." Thus, it is highly likely that any disputes related to the coronavirus outbreak will be treated as force majeure in China, exempting the party unable to perform from full or partial liability, depending on how seriously the party was affected and whether that party has satisfied applicable notice and other responsibilities.

Force majeure under CISG

The United Nations Convention on Contracts for the International Sale of Goods (CISG), which applies to international sales contracts if both parties are located in contracting states or if the private parties elect to be governed by it, does not use the term "force majeure," but it has adopted the force majeure doctrine implicitly. As the United States and China are both contracting states of the CISG, a significant number of contracts impacted by the coronavirus outbreak would be governed by the CISG. Under Article 79(1) of the CISG, a party is exempt from liability for a failure to perform any of its obligations if it proves that:

- the failure was due to an impediment beyond its control
- that it 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 the impediment or its consequences.

The CISG further exempts a party from liability if such failure is due to the failure of a third person whom that party has engaged to perform the whole contract or part of it. However, the CISG imposed notice requirements, mandating that the party affected must give notice to the other party of the impediment and its effect on its ability to perform within a reasonable time. 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, the non-performing party is liable for damages resulting from such non-receipt.

The jurisdiction and choice of law issues are extremely important in the international trade setting, as the question 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 U.S. law and the force majeure clause does not expressly identify that epidemic disease is force majeure, the affected party may not be able to invoke the coronavirus outbreak as force majeure or invoke 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.

Could the coronavirus outbreak qualify as a force majeure event?

The coronavirus outbreak presents a unique situation in that it contains both a naturally occurring component (the virus itself) and a government action component (including quarantines and other measures put in place

in response to the outbreak). Could the coronavirus outbreak qualify as a force majeure event? There is no simple answer to this question, as the inquiry would be very fact-specific as to each particular transaction – how the parties are affected with regard to a particular agreement. It also depends largely on the force majeure clauses in parties' contracts and which law applies.

The coronavirus is a completely new, severe, sometimes fatal illness and has quickly reached epidemic status. The recent coronavirus outbreak in China is the first time this coronavirus has affected human beings, so the occurrence of such event is likely an objective circumstance which is unforeseeable, unavoidable and insurmountable under Chinese law. The Chinese government additionally has taken various measures to prevent the further spreading of the virus. Thus, if Chinese law applies to a particular transaction, the person affected is likely to rely upon the force majeure event and be exempt from any contractual liabilities. This is true regardless of whether the coronavirus outbreak would constitute force majeure under a force majeure clause in an applicable contract.

However, the coronavirus outbreak may not automatically qualify as a force majeure event under U.S. law. If U.S. law applies, whether the coronavirus epidemic qualifies as a force majeure event will depend on the drafting and interpretation of the relevant force majeure clause. It is common for "epidemic" to be expressly included in the definition of force majeure. However, the absence of express reference to an epidemic would not necessarily prevent a coronavirus outbreak from being considered a force majeure event. It 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, could not reasonably have been anticipated before the contract, could not have been avoided or overcome and is not substantially attributable to the parties. Provided that the conditions set out in a force majeure clause are satisfied and it can be demonstrated that the outbreak will or has affected (as the case may be) the parties' ability to fulfil their contractual obligations, 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 those coronavirus-hit companies and to safeguard the rights and interests of those companies, the China Council for the Promotion of International Trade (CCPIT), accredited by the China Ministry of Commerce, is now offering "force majeure certificates" to businesses in China affected by the coronavirus outbreak. According to CCPIT's official website, "Some Chinese companies have suffered severe impacts on goods and logistics and may not be able to fulfil their contracts amid the coronavirus" and "businesses that have failed to perform on contracts on time, or fail to fulfil any international trade contract can apply to the council for a certificate." To minimize human contacts, coronavirus-

hit companies may apply for the force majeure certificates online via www.rzccpit.com, via the QQ messaging app or via telephone. To apply for the force majeure certificate, coronavirus-hit companies must submit:

- a certificate or announcement issued by the government or agency where the company is located
- a notice or certificate of sea, land and/or air-related delays and cancellations
- an export cargo sales contract, cargo booking agreement, freight agency agreement, customs declaration, etc.
- other available materials

It is worth clarifying that the issuance of force majeure certificates is a common practice in international trade. The CCPIT force majeure certificate confirms facts related to force majeure upon the applicant's application and proves the truthfulness of facts related to force majeure, such as natural disasters, sudden abnormal events and other objectively existing facts (in this case, the pneumonia outbreak of the new coronavirus infection). However, the CCPIT force majeure certificate does not determine whether the occurrence of the facts itself constitutes a force majeure event under any particular contract – that determination is left for the court or other dispute resolution tribunal.

Provide notice as soon as practically possible

"Force majeure notice" or "commercial impracticability notice" is generally required to trigger force majeure protection under a 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, a notice to the buyer that there will be a delay or non-delivery, and, when allocation is required, a statement of the estimated quota to be made available for the buyer. The party receiving the notice is thus made aware of what happened and may begin to seek measures to mitigate the damages. Such notice should be given immediately when it first becomes practically possible. For example, the UCC requires any commercial impracticability notice be given seasonably. While the UCC provides little guidance about what that means, the primary consideration in case law as to whether notice is "seasonable" seems to be the effect on the buyer. If the buyer is able to do something to mitigate the impact of the seller's delay or nonperformance, the seller should give notice to the buyer while the buyer still has time to take that mitigating action. Similarly, Chinese law requires the affected party to timely notify the other party "so as to mitigate the losses that may be caused to the other party." In any event, it is advisable to give the notice immediately when a delay first becomes practically possible. Even if the force majeure clause requires written notice by mail, which might be impracticable given the quarantines and restricted travel throughout China, it is still advisable to transmit such notice via email or other possible means as soon as possible.

Preserve all evidence related to the force majeure event

It is extremely important for the affected party to keep all documents related to the force majeure event. Such evidence may include related national, provincial and local government regulations, rules, notices and guidelines, news related to coronavirus outbreak, quarantines, mandatory shutdown of airports, train stations, sea ports, factories, cities or even provinces and restricted travel related your particular location or industries, 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 employees and customers related to a factory shutdown, late delivery or non-delivery, change of demand, or the cancellation of contract, any cancelled flight or train tickets or anything related to a travel itinerary, any road or factory shut down, any cancelled visa or permit or any 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 be important to keep all quarantine and healthcare documents such as hospital certificates, diagnosis information, discharge notices and other related documents.

How to react to the notice

It is important that the party receiving the above notice realize that these notices are meant to provide the supplier with a legal excuse for its nonperformance and to protect it from liability. Such notice cannot be ignored. The individual receiving such notice should immediately forward the notice and any correspondence associated with it to the management and its legal department. The party receiving the notice should closely scrutinize any notice that purports to give excuses for non-performance, partial performance or delay to determine whether the seller is attempting to invoke the force majeure doctrine or clause to avoid performance. The party receiving the notice should respond immediately to preserve its rights and seek as much information about the nature of the force majeure event as possible, such as the timing, the number of impacted products and facilities, and when the force majeure event is expected to conclude. If complete information is not available, the party providing the notice should supplement its notice as additional information becomes available. For the coronavirus outbreak, the party receiving the notice should inquire as to the number of coronavirus cases in the city where the party giving the notice is located, the government policies and reactions as to the coronavirus outbreak, and most importantly, to what extent the party giving the notice was impacted and its ability to continue performing the contract in whole or in part. Such an inquiry is important as it can help the party receiving the notice to plan its activities in light of the unavailability of the goods and strategically plan to mitigate its damages. It can also help the party receiving the notice to determine whether it should contest the seller's claim of excuse from performance. Moreover, if the party receiving the notice is also a seller who supplies its own customers in a supply chain, the person receiving the notice will have its own obligation to give notice

and supply information up that chain. Any information obtained during the inquiry process can be crucial in allowing the buyer to meet its own notice obligations up the chain to its own customers.

Assuming that the party receiving the notice decides to accept that a force majeure event has occurred under the agreement or as a matter of law, 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 actively seek alternative suppliers in order to mitigate its damages during the time period. To the extent the party receiving the notice is also a seller who supplies its own customers in a supply chain, that party should immediately notify its own customers and provide evidence related to the force majeure to its own customers.

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 products that can be accessed, to identify other manufacturing lines available at different locations, and 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 their respective insurance adjustors to handle the claims.

Prepare for possible dispute

While parties may wish to resolve a dispute amicably among themselves, the adverse impact of the coronavirus outbreak upon the performance of a particular transaction is a very fact-specific inquiry which 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.

For more information please contact Yuanyou (Sunny) Yang or any member of Porter Wright's International Business & Trade Practice Group.