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China's Supreme People's Court provides guidance on application of force majeure doctrine for COVID-19-related civil disputes

As the COVID-19 pandemic continues to spread across the globe, the supply chain of many countries, including the U.S. and China, have been, and will continue to be, severely interrupted. Many Chinese companies may find it difficult or impossible to fully perform commercial contracts with U.S. counterparties as a result of the COVID-19 outbreak. Many U.S. companies may similarly find it difficult or impossible to fully perform commercial contracts with Chinese counterparties for the same reasons. As COVID-19's impact threatens to upend contractual relationships between parties doing business under Chinese law, it is critical to understand the legal landscape related to the force majeure doctrine in China.

As discussed in detail in a previous [Porter Wright Law Alert](#), the doctrine of force majeure applies a bit differently in China than in the U.S. In the U.S., force majeure is a matter of contract. In other words, if the contract does not contain force majeure provisions, the court generally would not apply the force majeure doctrine, although the common law defense of frustration of purpose, impracticability or impossibility may come into play. However, the force majeure doctrine may be applied both by contract and, even if no contractual provision exists, as a matter of law in China. Under the Chinese law, both the General Principles of the Civil Law for the People's Republic of China (General Principles) and the Contract Law for the People's Republic of China (Contract Law) define force majeure events as "the objective circumstances that are unforeseeable, unavoidable and insurmountable." The Chinese courts can declare whether an occurrence constitutes force majeure, and such declaration would have the same legal effect as any rules or regulations. For example, in 2003 shortly after the

SARS outbreak, the Supreme People's Court for the People's Republic of China (Supreme Court of China) issued a judicial interpretation specifying that, if a contract could not be performed due to the SARS outbreak or any administrative measures adopted against SARS, such a situation was to be considered a force majeure event. However, while certain directives or guidelines were issued by the government or lower courts, the Supreme Court of China had not formally opined on whether the COVID-19 outbreak should be considered as a force majeure event at the time of the previous alert.

That situation has changed. On April 16, 2020, the Supreme Court of China issued its long-awaited [Guiding Opinion on Several Issues Concerning Proper Trial of Civil Cases Involving COVID-19 Pandemic \(One\)](#). In this opinion, the court provides detailed guidance to lower courts on applying force majeure and other principles to contracts when the performance of those contracts is impacted by COVID-19.

Application of force majeure doctrine

The opinion provides that “[f]or civil disputes directly affected by the COVID-19 outbreak or the prevention and control measures taken against COVID-19 that meet the statutory requirements of force majeure, the lower courts shall properly apply Article 180 of the General Principles and Article 117 and Article 118 of the Contract Law, unless other laws or regulations apply.” *Opinion, Article 2*. The opinion emphasizes that, in applying the force majeure doctrine, the lower courts should consider the “impact of the COVID-19 on different regions, different industries, and different cases, analyze the impact of the COVID-19 outbreak itself and any prevention and control measures taken against COVID-19, as well as their direct relationship with the non-performance of any contract”, and should not apply a one size fits all approach. *Opinion, Article 3*. The party invoking the force majeure doctrine shall bear the burden of proving that the force majeure event directly led to the failure of part or all of its contract obligations. *Opinion, Article 2*.

Specifically, the opinion provides that if the COVID-19 outbreak or prevention and control measures against the COVID-19 outbreak directly led to the failure to perform, the force majeure doctrine should apply, and the liability would be partially or completely exempted based on the impact of the pandemic or prevention and control measures against the pandemic. However, “if a party has imputable reasons for the failure to perform the contract or the increase of losses, the party will bear corresponding liabilities.” *Opinion, Article 3(1)*. In addition, the People's Court will consider whether the parties have received government subsidies or tax or fee reductions or others subsidies, or debt relief as a result of the pandemic in determining whether a party must continue to perform its contract obligations. *Opinion, Article 3(3)*.

In addition, the opinion clarifies that if the COVID-19 outbreak or prevention and control measures taken against the spread of COVID-19 only caused difficulties in contract performance, such situation shall not

be considered as force majeure and the People's Court will not support a party's claim to cancel or terminate the contract based on the difficulties to perform only. *Opinion, Article 3(2)*. Instead, the People's Courts are encouraged to engage in effective mediation and actively guide the parties to continue to perform. *Id.*

In furtherance to the opinion, the Head of the Research Office of the Chinese Supreme Court pointed out in the April 20, 2020 "[Head of the Research Office of the Supreme People's Court's Answer to Press's Questions on the Issuance of Guiding Opinion on Several Issues Concerning Proper Trial of Civil Cases Involving COVID-19 Pandemic](#)"

that the opinion was based on the general contract principle to respect and recognize the parties' agreement, as long as such agreement does not violate the mandatory provisions of the law or public order and good custom. In other words, if the parties to a contract already have a force majeure provision defining force majeure events and providing the procedures to follow in the event of force majeure, such provision will generally be respected by Chinese courts.

Therefore, under the opinion and answer, whether a party to the contract would be exempted from part or all liability under the contract based on the force majeure doctrine will be reviewed on a case-by-case basis under the specific facts of each case. The key elements that a Chinese court may consider are:

1. Whether the COVID-19 outbreak directly caused the failure of performance or failure to achieve the purpose of the contract;
2. Whether the contract was entered into before or after the COVID-19 outbreak;
3. Whether the party invoking the force majeure doctrine is at fault for failure to perform;
4. Whether the party invoking the force majeure doctrine used reasonable endeavors to avoid the effects of the extreme circumstance; and
5. Whether the failure results from the COVID-19 outbreak itself or the measures taken by the administrative governments for preventing and containing the outbreak.

Even if the court finds that force majeure has occurred, to claim the occurrence of a "force majeure" event, the defaulting party must timely notify the other party of the force majeure event, and take proper mitigation measures to minimize damages under the Chinese law. Failure to do so may result in a party being unable to exempt all or part of its liabilities to which it may have been originally entitled. In addition, the Chinese law requires the invoking party to provide certifying documents. While Chinese law did not define what constitutes "certifying documents," it is likely that the force majeure certificate issued by the China Council for the Promotion of International Trade (CCPIT) may satisfy the certifying

documents requirement.

The directives provided in the opinion and the answer are important in analyzing whether a party would be liable for its failure to perform under the contract, particularly given the different directives granted in different parts of China in response to COVID-19. As discussed in more detail in the previous Porter Wright Law Alert, almost all major cities or provinces have issued certain rules or recommendations to stop the spread of COVID-19, either required or encouraged companies to ask their employees to stay at home, or in some cases shut down businesses for various periods of time. Differing requirements may provide room for arguing the manner in which force majeure provisions apply, particularly where government makes a recommendation only, rather than rules that must be strictly followed.

Other relevant factors may be:

- The date that such directives are issued;
- The length of time prior to or immediately after a period covered by a government directive; and
- The nature of business being conducted.

Therefore, it is important to do a case-to-case analysis in determining whether and to what extent the force majeure doctrine may apply.

Application of material adverse change doctrine

The opinion also addresses the “material adverse change” doctrine. This Chinese law doctrine is similar to, but a bit less stringent than, the frustration of purpose doctrine in the U.S. It allows a party to petition the court under Article 26 of the Supreme People’s Court of China’s Interpretation No. 2 on the Contract Law, requesting modification to terms of the contract (including the termination of a contract) when there is a significant change to an underlying circumstance which is the basis for contract performance (such as a substantial change to China’s national policies, laws or exchange rate). A petitioner invoking the “material adverse change” doctrine must demonstrate that such change occurred after contract execution, and that such occurrence was unforeseeable when the contract was executed, is not caused by a force majeure event and is not a commercial risk. The court examines the petition and the specific facts of the case using the principle of fairness in deciding whether to allow changes or termination of the contract.

Specifically, in dealing with the COVID-19 situation, the opinion provides that if the COVID-19 outbreak or prevention and control measures taken against the spread of COVID-19 only caused difficulties in contract performance but did not make the performance impossible, yet the continued performance is obviously unfair to one party, the affected party may request an amendment of the performance period, performance method, price amount, or other contract terms, and the People’s Courts were instructed to make the decision based on the factual circumstances of each case. *Id.* The opinion further provides that if the purpose of the contract cannot be realized due to the COVID-19 outbreak or prevention

and control measures taken against the spread of COVID-19, and the parties request the termination of the contract, the People's Court shall support it. *Id.*

However, it is worth noting that, historically, the "material adverse change" doctrine was rarely applied in practice, because Chinese law also follows the principle of encouraging transactions. In fact, even in dealing with the COVID-19 situation, the answer explained that the opinion was issued based on that principle. Therefore, it is the Chinese courts' view that, if the parties will be able to perform by revising the contract, they should negotiate an amendment, rather than terminating the contract. As the opinion explained, courts should not support claims for contract termination due to "difficulty" in performance, and courts are required to mediate and encourage performance. The Chinese court would uphold a request for termination only if the COVID-19 or prevention and control measures against COVID-19 would make it impossible to realize the purpose of the contract (similar to the "frustration of the purpose" doctrine in the U.S.).

Tolling of statute of limitations

Under the General Principles, force majeure events can "pause" the running of any statute of limitations. The opinion now tolls statutes of limitations for six months as a result of the COVID-19 outbreak. Specifically, if a party is unable to exercise its right of claim due to the COVID-19 outbreak or any prevention and control measures taken against the spread of COVID-19 during the last six months of the statute of limitations period, the court will find that the statute of limitations has been tolled. In deciding whether a party is unable to exercise its right of claim due to the COVID-19 outbreak or any prevention and control measures taken against the spread of COVID-19, the People's Court shall "fully consider the extent of the affected party's area affected by COVID-19 and the circumstances under which the prevention and control measures taken against the spread of COVID-19 were taken, and make a comprehensive determination based on the evidence materials provided by the parties." Answer, No. 5. "For regions where the COVID-19 situation is more serious, the review standards can be appropriately relaxed according to the actual situation, and as long as the evidence submitted by the parties can prove that the delay period is not due to the negligence of the exercise of litigation rights, it can generally be permitted." *Id.*

In addition, if a party is a patient diagnosed with or suspected of COVID-19, including an asymptomatic infection, or is quarantined due to a related close contact with a person who has been diagnosed with or suspected of COVID-19, including an asymptomatic infection, and the statute of limitations has expired during the isolation or treatment period, that party may submit an extension request under Article 83 of the Chinese Civil Procedure Law and the People's Court will permit the party to file a lawsuit.

Therefore, if a party missed filing of a lawsuit because of COVID-19 and it has been less than six months since any applicable statute of limitations has expired, the party should take the opportunity to file the lawsuit now, arguing that the statute of limitations was tolled.

Conclusion

Although the COVID-19 pandemic has moved into a recovery and control phase in which businesses are now open in China, the ongoing global problems are causing further issues to some China-related contracts. As businesses attempt to re-negotiate and re-set their contractual relationships, issues of liability will inevitably arise and parties with China-related contracts should consider the application of the force majeure and “material adverse change” doctrines under the Chinese law.

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