

COVID-19: THE LEGAL CONSEQUENCES OF COVID-19 ON YOUR CONTRACTS: FORCE MAJEURE IN DIFFERENT JURISDICTIONS AND INDUSTRIES, AND SOME PRACTICAL GUIDANCE

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INTRODUCTION

The novel coronavirus ("COVID-19") outbreak has resulted in robust mitigation and containment measures being taken by countries around the world and is having significant and broadening negative impacts on business activities. From a legal perspective, these negative impacts may make it difficult or impossible for parties to a contract to perform their obligations. However, a great deal depends on the nature of the event and its impact on the specific contract and its performance by the parties.

With the COVID-19 outbreak, the virus and associated actions to contain it are affecting countries and industries differently. The high number of infections in the People's Republic of China ("PRC") has caused the government authorities there to take strong measures which have substantially disrupted and decreased economic activity. Travel into and out of the PRC has been restricted, and international supply chains have been disrupted. Similar measures may be taken by an increasing number of countries before the outbreak finally subsides.

WHAT RELIEF MAY BE AVAILABLE TO YOU IF YOUR CONTRACT IS AFFECTED BY THE COVID-19 OUTBREAK?

In such a situation, what relief, if any, may a party to a contract have if it is unable to perform its contractual obligations? On the one hand, a contract which requires something to be done on a particular date in a specific manner may truly be impossible to perform if no one can actually carry it out, irrespective of the cost. The affected party may be completely excused from carrying out the contract. On the other hand, if what the contract requires can be carried out but to do so would be much more expensive and difficult, then the party affected by the negative effects of the COVID-19 outbreak may have no valid legal reason to refuse to perform the contract. Indeed, the refusal by a party to perform a contract during the COVID-19 crisis without a valid legal reason risks substantial liability in damages and potentially termination for breach of contract. In addition, each legal system (common law and civil law), country and contract is likely to provide a different answer to these issues.

THE EFFECT OF GOVERNMENT ACTION AND MEASURES

Further, action by countries in response to the COVID-19 outbreak may affect the legal position of parties that have difficulty in performing their contractual obligations. In the PRC, on 10 February 2020, a spokesperson of the Legislative Affairs Commission of the Standing Committee of the National People's Congress stated that in the face of the COVID-19 outbreak, the government has taken mitigation measures which constitute force majeure to contracting parties that cannot perform a contract because of those measures¹. This statement does not establish force majeure in itself but highlights that the measures are likely to be regarded to constitute force majeure by one of the highest legislative bodies of the PRC when it makes the performance of contractual obligations impossible. How the PRC courts will rule in individual cases is beginning to emerge. The Hubei Provincial High Court recently advised its lower courts that the COVID-19 epidemic and related government measures constitute force majeure, and the court may terminate the contract upon application of a party if the contractual purpose of the relevant contract cannot be realised because of the COVID-19 epidemic or related government measures².

In addition, the China Council for the Promotion of International Trade started to issue force majeure certificates to Chinese companies in early February 2020. The effectiveness of these force majeure certificates in the context of recognised principles of force majeure under PRC law is uncertain and untested. These certificates may help a party to a dispute in the PRC to argue that the COVID-19 outbreak is force majeure, but it will still have to show that the requirements to establish force majeure under PRC law are met. Such certificates are likely to carry less weight with the courts and arbitration tribunals outside the PRC, which are more likely to focus on the effect of the contracts and applicable principles of law against all the available evidence to determine whether an event of force majeure has occurred.

DIFFERENT LEGAL SYSTEMS

Although force majeure is widely referred to by businessmen around the world as an unforeseen event that can affect the performance of a contract, it is not as well known that there are substantial differences between the legal basis to establish force majeure in a common law and civil law country or legal system. Under the common law, there is no definition of force majeure; it must be defined and provided for under the contract. Where the contract does not provide for force majeure, a party may only be able to rely on the principle of frustration to avoid performing the contract. The principle of frustration is hard to prove and is rarely used.

In civil law, the general law defines and provides remedies for force majeure, which may be in addition to what is provided for in the contract. So where civil law applies, if the contract does not provide for force majeure, a party that is impeded or unable to perform its contract may still be able to rely on the general law to establish force majeure and obtain relief from the performance of the contract. In this sense, it might be said that the civil law is more helpful to a party that is adversely affected by an event of force majeure. In any event, it underscores the importance of checking the governing law of the contract in question.

WHAT SHOULD I DO?

Some effects of the COVID-19 outbreak are obvious, such as, travel restrictions, lock-downs, quarantines, and shortages of medical and safety equipment, but their immediate impact on contracts, such as, the ability to pay, deploy resources on time and meet service levels as agreed, and the amount of increased costs may be less so. Careful consideration should be given to contracts that are most affected by the effects of the COVID-19

outbreak. In addition, where there is doubt over a claim for force majeure in contract or under the general law, you should also consider if you may make an insurance claim to cover or reduce losses caused by the COVID-19 outbreak. With this in mind, below are:

questions and answers addressing key questions and issues;

a flowchart to help with the review of contracts;

a table which sets out some of the potential issues and actions to consider for different industry sectors (aviation, construction and engineering, insurance coverage, liquefied natural gas ("LNG") and technology, media and telecom ("TMT")); and

some drafting tips to address the COVID-19 outbreak or a similar future event if you are preparing a new contract or revising an existing one.

Q&A

Ref.	Questions	Answers
Q1	What is force majeure?	Force majeure is an event that is beyond the control of the parties to the contract, which may or may not have been unforeseeable, the effects of which cannot be avoided by reasonable efforts or due diligence, the consequences of which is to impede or prevent the performance of the contract. Under the common law, the performance of the relevant contract obligation must have been prevented by an event of force majeure and not merely hinder it or render it more onerous. Examples of force majeure include acts of God, fire, war, riot, civil commotions, disease, epidemic, pandemic, embargos and government intervention or action.
Q2	What is frustration?	Under the common law, a contract is frustrated when a supervening event occurs which so fundamentally affects the performance of the contract that it is automatically terminated and the parties are discharged from future performance of the contract.
Q3	Is my force majeure clause valid and enforceable?	The validity and enforceability of each clause and its contract must be considered in the context of its governing law and corresponding system of law.
Q4	What is an epidemic? What is a pandemic?	An "epidemic" refers to the occurrence of disease that is temporarily of high prevalence, while "pandemic" refers to an epidemic that spread over a wide geographical area ³ . On 31 January 2020, the World Health Organization ("WHO") declared the COVID-19 outbreak a public health emergency of international concern. The WHO has not at this point declared a global

		pandemic.
Q5	When can a contract be renegotiated?	<p>In general, the parties to a contract are free to renegotiate its terms by agreement.</p> <p>In the civil law jurisdictions, the renegotiation and judicial revision of contracts maybe available in the event of force majeure⁴. Under the PRC law, a party may apply to court to revise or terminate a contract when changed circumstances render the continued performance of the contract obviously unfair or make it impossible to realise the contractual purposes⁵. The French, United Arab Emirates ("UAE") and Qatari civil codes explicitly provide that a party may ask the other to renegotiate the contract in view of <i>imprévision</i>⁶, and when the renegotiation is refused or fails, the parties may agree to terminate the contract or ask the court to revise or terminate the contract⁷</p>
Q6	Will I need to give notice of a force majeure event?	<p>If your contract has a force majeure clause, it is likely that it will contain notice provisions. These notice provisions should be carefully followed. In addition, a force majeure clause may require the production of a certificate issued by a designated authority certifying the circumstances giving rise to or the occurrence of an event of force majeure⁸ Even if there is no express requirement for notice, reasonable notice should be given to the other party that you are relying on the force majeure clause to suspend or terminate the contract. Indeed, the PRC Contract Law explicitly requires a party relying on force majeure to timeously notify the other party so as to mitigate the losses that may be caused to the other party⁹.</p>
Q7	Can I suspend and/or terminate the contract in the event of force majeure?	<p>In a common law jurisdiction, the contract can be terminated or suspended as long as the relevant clause provides for it¹⁰.</p> <p>In the civil law jurisdictions, the contract can be suspended or terminated, depending on the impact of the force majeure event on contractual performance. Under the French Civil Code, if the prevention of contractual performance is temporary, performance of the contract would be suspended unless the delay would justify termination. If the prevention is permanent, then the contract is terminated by operation of law unless the performing party agrees otherwise. The French Civil Code allows partial discharge of the performing party's liability depending on the impact of the event of force majeure¹¹</p>

CHECKING YOUR CONTRACT: FORCE MAJEURE

https://files.klgates.com/files/Uploads/Documents/Contract_Force_Majeure.pdf

Click on the image to view the full-size chart.

POTENTIAL IMPACTS ON DIFFERENT SECTORS

Sector	Potential Issues	Actions to consider
Aviation	<p>Impacts on operations for airlines and aircraft delivery and maintenance.</p> <p>Original equipment manufacturers of fleet and their suppliers may suffer storage and logistics difficulties.</p>	<p>Seek legal advice. Assess relevant contract(s) and severity of impact(s).</p> <p>Negotiations to avoid default(s).</p> <p>Consider full solvent restructuring options to simplify corporate structure and reduce costs and/or compliance burden.</p> <p>Consider subleasing or wet leasing fleet to geographical markets that are less affected.</p> <p>Consider amending leases, sub-leases, security documents and/or deregistering/registering aircrafts.</p>
Construction and Engineering	<p>Construction programme delays and effect on completion if any.</p> <p>Unavailability or shortage of materials and workers.</p> <p>Pressure on project cash flow.</p>	<p>Seek legal advice. Assess relevant contract(s) and severity of impact(s).</p> <p>Negotiations to avoid defaults.</p> <p>Request extension(s) of time if there is a contractual ground to do so.</p> <p>Check for right to suspend the works and issue notices.</p> <p>Consider the impact on project cash flow and ability to pay subcontractors, suppliers and workers.</p> <p>Secure the supply of materials and workers.</p>
Insurance	Business disruption.	Seek legal advice. Assess relevant

<p>coverage</p>	<p>Event cancellation.</p> <p>Supply chain disruption.</p> <p>Directors and officers liability.</p>	<p>contract(s) and severity of impacts.</p> <p>Review business disruption, event cancellation, directors and officers liability and other insurance policies for coverage and exclusions. Notify claims.</p> <p>See also K&L Gates HUB, dated 27 February 2020, "<u>Coronavirus Losses: Will Your Commercial Insurance Policies Respond?</u>"</p>
<p>LNG</p>	<p>Disruption to production and non-delivery.</p> <p>Force majeure declarations by LNG buyers.</p> <p>Non-payment.</p>	<p>Seek legal advice. Assess relevant contract(s) and severity of impact(s).</p> <p>Negotiations to avoid default(s).</p> <p>See also K&L Gates Legal Insight, dated 14 February 2020, "<u>Coronavirus Force Majeure Declarations by LNG Buyers - A Negotiating Tool or a Legitimate Case of Force Majeure for LNG SPAs Governed by English Law?</u>"</p>
<p>TMT</p>	<p>Potential and/or actual severe delay or even non-delivery of hardware, software or other TMT equipment.</p> <p>Non-performance of support services (such as software development, maintenance and installation but also other professional services) due to disruption in supply chains.</p> <p>Non-availability of parts, equipment, technology or personnel due to travel restrictions or changes in workplace behaviour.</p>	<p>Seek legal advice on your supply contracts, in particular on any potential contractual defaults/breaches (and any possible regulatory issues that may impact you, where applicable), whether any contractual savings clauses such as force majeure clause would apply, and courses of action to avoid any such defaults.</p>

DRAFTING TIPS

Below are some drafting tips to address COVID-19 or a similar future event.

1. Make sure your contract has a force majeure clause to cover COVID-19 or a similar future event. Decide if the clause should be open and unqualified or a closed list of force majeure events.
2. Consider how the governing law of the contract affects the force majeure clause in the contract.
3. Make sure that there are clear provisions to notify an event of force majeure and state the time within which such notice must be provided.
4. Provide for rights to suspend and terminate as appropriate, as well as the time period of suspension before the right to terminate can be exercised.
5. Require the party that claims force majeure to mitigate the effects of the force majeure event.
6. Consider if all obligations should be suspended during the period of suspension or if specific obligations, such as payment, should continue in any event.
7. Consider if any matter should be excluded when force majeure is considered by a court or arbitration tribunal, such as severe price spikes or declines.
8. If an arbitration clause is selected, ensure that the arbitration rules of the relevant arbitration institution provide for emergency arbitration procedures.

NOTES

[1] http://www.xinhuanet.com/2020-02/10/c_1125556153.htm (in Chinese).

[2] The Second Civil Division of Hubei Provincial High Court, *Reply to Several Questions in Adjudicating Commercial Cases Involving COVID-19 Epidemic* (关于审理涉及新型冠状病毒肺炎疫情商事案件若干问题的解答), 12 February 2020.

[3] Epidemic (Pathology), Encyclopedia Britannica.

[4] Article 77 of the PRC Contract Law; parties have a general right to voluntarily agree to renegotiate and modify the contract.

[5] Article 26 of the Interpretation II of the Supreme People's Court of Several Issues concerning the Application of the PRC Contract Law (promulgated on 24 April 2009, effective on 13 May 2009). However, the Supreme People's Court stated in a subsequent notice that power given to courts thereunder must be exercised judiciously: *Guiding Opinions on Several Questions in Adjudicating Civil and Commercial Contract Disputes in the Present Circumstances* (关于当前形势下审理民商事合同纠纷案件若干问题的指导意见), 14 July 2009.

[6] *Imprévision* is a civil law principle which may allow the renegotiation or judicial revision of contracts where there is an unforeseeable event or changed circumstance which causes the performance of the contract to become excessively burdensome and/or obviously unfair.

[7] French Civil Code Art.1195 (2016); UAE Civil Code Art.249; Qatar Civil Code Art. 171(2).

[8] *Magenta Resources (S) Pte Ltd v China Resources (S) Pte Ltd* [1996] 2 SLR(R) 316 (Contract for supply of USSR origin goods. Whether a certificate issued by the USSR Embassy in Singapore certifying the USSR ceasing to exist was sufficient to satisfy the contractual requirement for a certificate issued by "competent authority at the place where the force majeure event occurred", so that the FM Clause was properly invoked).

Certificates issued by organisations such as China Council for the Promotion of International Trade ("CCPIT") may be helpful to prove force majeure. As at 14 February 2020, the CCPIT has issued more than 1,600 certificates regarding the COVID-19

outbreak: http://www.ccpit.org/Contents/Channel_4324/2020/0216/1240959/content_1240959.htm As noted above, these certificates may have limited evidential value in international arbitration and litigation unless the force majeure clause specifically provides that such certificates are conclusive proof of a force majeure event. See Philip Yang: *COVID-19 Epidemic and Force Majeure under International Commercial Contracts*, <http://www.xindalilaw.com/newsitem/278331912>.

[9] Art.118.

[10] This is different from discharge under the doctrine of frustration.

[11] French Civil Code Arts. 1218, 1351, 1351-1 (2016).

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