

Understanding the Application of Force Majeure and Changed Circumstances under PRC Law

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The outbreak of the novel Coronavirus (COVID-19) has created much uncertainty among foreign companies doing business in China. In the following, we look at the legal requirements and consequences on the performance of contracts due to Force Majeure and Changed Circumstances under PRC law.

Force Majeure

A. Applicability

According to **Article 117** of the Contract Law of the PRC: *“Force majeure as used herein means objective situations which cannot be foreseen, avoided or overcome.”*

According to **Article 180** of the ‘General Principles of the Civil Law of the PRC’: *“No civil liability is borne in case of failure to perform civil duties due to Force Majeure, unless otherwise provided by law. Force Majeure refers to unforeseeable, unavoidable and insurmountable objective situations.”*

Under PRC law, Force Majeure affords a **statutory exemption from liability** as long as the affected party can prove that failure to perform was due to a Force Majeure event. This means that Force Majeure also applies to contracts without Force Majeure articles and contracts explicitly excluding Force Majeure situations.

B. Direct Consequences

1) Annulment of the contract if the purpose of the contract cannot be realized.

According to **Article 94 (1)** of the Contract Law of the PRC: *“The parties may dissolve the contract in the following circumstances: If the purpose of the contract cannot be realized because of Force Majeure;”*.

Article 96 further states that: *“if a party wants to terminate the contract in accordance with Article 93 (2) and Article 94, it shall notify the other party. The contract is terminated when the notice reaches the other party. If the other party disagrees, it may seek confirmation of the validity of the contract from the People’s Court or arbitration institution.”*.

If the aim of a contract cannot be fulfilled due to Force Majeure, either party can revoke the contract and be exempted from any liability. The affected party shall provide sufficient evidence proving that a causal relationship exists between the referred Force Majeure situation and the impossibility of fulfilling the purpose of the contract.

2) Partial or full exemption from liability of breaching contract.

According to **Article 117** of the Contract Law of the PRC: *“If a contract cannot be performed due to force majeure, part or all of the obligations may be exempted, depending on the impact of the force majeure, unless laws provide otherwise. If force majeure occurs after one party has already delayed its fulfillment, its obligations may not be exempted.”*.

If a party cannot perform its obligations in a contract because of Force Majeure, but this does not lead to a failure of realizing the purpose of the contract, the breaching party cannot invoke Force Majeure to cancel the contract, but is fully or partially exempted from liabilities. The exemption of liabilities is only limited to the extent the contract cannot be performed due to Force Majeure.

If a contract can only be partially performed due to Force Majeure, the parties can amend the contractual terms and agree to partially exempt any liabilities for breach of contract.

If Force Majeure only temporarily prevents the performance of the contract and a delayed performance will not lead to the failure of realizing the purpose of the contract, the performance shall be postponed and the breaching party shall be exempted from delayed implementation.

However, where Force Majeure occurs after a party was already late in performing its obligations, the said party will not be excused from any liability.

3) Parties to share losses suffered from Force Majeure

Normally, the parties shall equally and reasonably share the losses suffered due to Force Majeure but this shall be assessed on a case by case basis.

Generally speaking, for delivered services/goods which are not affected by Force Majeure, these shall be paid for in full in which any additional costs for the adoption of alternative solutions or postponed performance shall be shared by the parties. However, if the services/goods provided by an alternative solution increases the price, the additional costs shall be covered by the receiving party.

C. Procedures of invoking Force Majeure

If both parties have agreed on the procedures for invoking Force Majeure in a contract, the terms of the agreement shall be followed. Otherwise, the parties shall follow the applicable laws and regulations.

According to **Article 118** of the Contract Law of the PRC: *“Either party that is unable to perform the contract due to force majeure shall **immediately notify** the other party to reduce potential losses inflicted on the other party and shall provide evidence thereof within reasonable time.”.*

Article 119 also states that: *“After either party breaches the contract, the other party shall take appropriate measures to prevent any increases in the losses sustained; where any party fails to take appropriate preventive measures, and this leads to increased losses, the party may not demand compensation for these additional losses.”.*

The non-performing party shall promptly notify the other party about the Force Majeure situation and shall within reasonable time provide sufficient supporting evidence.

It is here suggested to take such steps as collecting supporting evidence of the Force Majeure situation and its impact on contract performance, taking appropriate measures to prevent any increase in the losses sustained and negotiating with the counterparty for solutions and/or alternative measures.

The supporting evidence normally includes the official announcement (or issued certificate) from the relevant authorities, the communication and confirmation by the parties in relation to the Force Majeure situation, evidence showing that the parties have already taken appropriate measures to prevent or reduce further losses (i.e. sell perishable goods at lower prices or actively search for alternative materials).

Changed Circumstances

The term “Changed Circumstances” also refers to unforeseeable situations like “Force Majeure” but can only be used to challenge the validity of a contract and its continued performance due to objectively changed circumstances.

According to **Article 26** of ‘The Interpretation of the Supreme People’s Court on Several Issues Concerning Application of PRC Contract Law’: *“if any significant change in the objective environment has taken place after the completion of a contract which could not have been foreseen by the relevant parties at the time of entering into the contract, and caused a major change that is not a commercial risk caused by force majeure, making the continued performance of the contract obviously unfair to the relevant party or making it impossible to fulfill the purpose of the contract, the People’s Court shall determine whether the contract shall be changed or terminated according to the principle of fairness taking into account the actual circumstances of the case.”*

In a situation of Changed Circumstances, it is **possible but impracticable** to perform the contract as is clearly unfair to one of the parties. However, under Force Majeure the contract cannot be performed and the purpose of the contract cannot be realized.

To claim Changed Circumstances, the non-performing party shall file a petition to the competent People’s Court for judgment based on the **principle of fairness**. This means that whether or not Changed Circumstances applies shall be based on the ruling of the People’s Court. In case of Force Majeure, it is not necessary to involve the People’s Court.

For instance, with COVID-19 it is likely that the costs of certain materials will increase. Continuing the performance of some contracts is still possible but this may lead to great losses to the parties. The affected party may therefore want to petition the People’s Court to modify or terminate the contract.

Force Majeure, Changed Circumstances and COVID-19

According to Tie Wei ZANG (10 February 2020), spokesman of the 'Law Committee of the National People's Congress of the PRC', the outbreak of COVID-19 is considered as a Force Majeure situation in contractual disputes. Whether a contract can be revised or cancelled shall be determined on a case by case basis.

There are three types of non-performance of a contract: 1) the whole contract cannot be performed; 2) part of the contract cannot be performed; and 3) the obligations cannot be performed temporarily.

If the purpose of a specific contract cannot be fulfilled due to COVID-19, a party can refer to Force Majeure for cancellation of the contract and/or be exempted from liability. The party that initiates the termination shall notify the counterparty and provide supporting evidence as stated in Article 118 of PRC Contract Law.

If a specific contract can be performed but the continued performance of the contract is obviously unfair to the relevant party or makes it impossible to realize the purpose of the contract, the affected party can petition the People's Court to change or revoke the contract.

Way Forward

In case of COVID-19 or any natural disasters, it is very important that the parties review their contracts regarding the procedures for declaring and handling Force Majeure and take appropriate measures to prevent any increase in the losses sustained.

Given the global disruption to production, supply chains and logistics, the parties need to communicate and negotiate in good faith to find solutions and alternative ways that can alleviate the negative (financial) impact on both parties.

At China-direct.biz we have the required expertise and experience in reviewing and preparing contracts and handling contractual disputes according to PRC Law.

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