

Fallout from the Coronavirus: Chinese Businesses Increasingly Seek Force Majeure Exemptions from Contractual Performance and Penalties—Options Available to Affected Businesses

The first two weeks of February—which followed on from the original public holiday period for the Chinese New Year—have seen numerous Chinese businesses unable to resume manufacturing, or unable to take shipments of exports. As the spread of the coronavirus outbreak continued, and likewise its severity remained insufficiently determined, many levels of government across China ordered delays to return to work locations, or even imposed local movement lockdowns. At the same time, numerous foreign countries have implemented travel bans, substantially impacting the capacity to ship goods by air (though surface shipments have largely remained unaffected). Amid this backdrop, Chinese companies of varying scale are increasingly facing tough decisions and asserting force majeure to seek excusal from contractual performance duties or penalties, which in turn is posing major challenges for foreign counterparts. This client alert advises options available to businesses on both sides.

I. Overview of Situation & Notable Recent Force Majeure Declarations

The following points offer key highlights regarding the work shutdowns and force majeure actions taken so far:

- Many of the delays to resumption of work have been caused by government orders for people to remain at home (which can have a minimal impact on certain service industries, but have a major impact on manufacturing), with the Chinese central government allowing provinces and cities to determine return to work dates at their own discretion based on the virus' spread. For example, 59 million people remain under government-ordered quarantine in Hubei province, the center of the outbreak, and major cities Chongqing and Chengdu, not far from Hubei, are among 80 cities where governments have imposed local movement lockdowns. At the same time, other delays have been voluntarily imposed, with two of China's largest technology companies, Alibaba and Meituan, extending their employees' Chinese New Year holiday period until at least February 16.
- The regions most heavily affected by the shutdowns—Guangdong, Shandong, Zhejiang, etc.—contribute 70% of China's GDP and are responsible for 80% of its exports.
- Since on or around February 2, local trade organization, the China Council for the Promotion of International Trade (CCPIT), aka the China Chamber of International Commerce, has been issuing force majeure certificates to Chinese companies for use in relation to international contracts. As of February 3, the CCPIT had reportedly received over a thousand inquiries regarding these certificates.
- On or around February 2, Zhejiang-based Huida Manufacturing (Huzhou) Co. advised Peugeot that it would not be supplying steering-system parts for Peugeot's African assembly line, claiming force majeure, for which it tendered a CCPIT-issued certificate. Reportedly, the refusal to supply would cause Huida a loss of approximately US\$ 340,000 in payments from Peugeot, but the force majeure declaration if honored would save it approximately US\$ 4.3 million in contractual penalties for the two-week period claimed.
- On February 5, South Korean-based car manufacturer Hyundai announced that as of February 7, it would halt car manufacturing lines in South Korea because of supply chain issues in China, anticipating a staggered resumption of production on or about February 11. In addition, on the same day, it was reported that BMW, Ford, Honda, Nissan, Toyota, and Volkswagen were extending delays to resumption of their local manufacturing in China.
- On or around February 6, China's biggest importer of liquefied natural gas, China National Offshore Oil Corp., sent force majeure notices to Shell and Total S.A. to suspend purchase contracts.

- On February 7, it was reported that Total S.A. had had rejected a force majeure notice from a liquefied natural gas purchaser in China.
- On or around February 7, multiple Chinese copper traders, including Guangzhou Zhongshan Trade and Shenzhen Yongfulu, asked miners from Chile, Nigeria, Somalia, and elsewhere to cancel or delay shipments, citing force majeure due to the epidemic's impact on demand.
- As of February 11, Apple's iPhone manufacturer Foxconn advised that it was recalling its employees in phases, and it expected that it would take weeks for a resumption of full production. It was speculated that this might delay the launch of Apple's newest iPhone, due for release in March.
- Apart from these specific reports, there are also general reports of soybean shipments from Brazil and the United States, as well as palm oil shipments from Indonesia, being held up at Chinese ports. It is also reported that China's largest oil and gas company, PetroChina, has been forced—without declaring force majeure—to delay release timings for multiple cargo shipments because they cannot find enough workers to run their refinery terminals at full capacity.

II. The Doctrine of Force Majeure & Similar Applications

An overview of the legal doctrines relating to force majeure, and examples where it has been applied, are as follows:

- Under Chinese law, the concept of force majeure has been codified—under the term “bu ke kangli”—in the General Principles of Civil Law and Contract Law statutes. For instance, the National People's Congress' official English version of the Contract Law provides at Article 117 that, “If a contract cannot be fulfilled due to force majeure, the obligations may be exempted in whole or in part depending on the impact of the force majeure ... Force majeure as used herein means objective situations which cannot be foreseen, avoided or overcome.” Then under Article 118, a “party that is unable to fulfill the contract due to force majeure shall notify the other party in time in order to reduce losses possibly inflicted to the other party, and shall provide evidence thereof within a reasonable period of time.”
- In addition, the United Nation's Convention on Contracts for the International Sale of Goods (CISG), adopted by China, United States, and 91 other countries and often the governing law by default of international sale of goods contracts with Chinese parties also contains what is commonly known as a force majeure provision at Article 79. This provision excuses liability for failure to perform contractual duties due to circumstances beyond the non-performing party's control, and which could not reasonably have been taken into account when the parties entered into the contract. Under the rule, the exemption lasts only so long as the impediment exists and notification must be given.
- In common law jurisdictions such as the United States, the term often features only in specific contractual provisions—“force majeure clauses”—that deal with situations akin to the French Civil Code's definition, but that can also reflect the idiosyncratic agreement of the parties as to the scope of circumstances covered (epidemics may not be specifically listed) and potentially what liability is exempted. The most analogous doctrine under the common law is that of impossibility or impracticability, allowing exemption from performance due to a supervening cause not foreseen at the time of contracting. (The specifics and application of this doctrine will vary slightly according to state body of law under which a relevant claim is asserted.)
- In recent Chinese legal history, the SARS epidemic of 2002-03 saw relatively widespread use of the Chinese law force majeure doctrine. In 2003, the Supreme People's Court issued a judicial interpretation instructing lower courts to treat any inability to perform a contract caused by government epidemic measures as a force majeure scenario. Chinese courts in the current epidemic are already referring to this precedent: on February 7, the Fangshan District Court in Beijing issued a release on the Beijing Courts website recommending the use of this approach for the current epidemic. Of note, in its release, the Fangshan court also recommends not treating any non-

performance during the epidemic that was caused by negligence on the part of the non-performing party as a force majeure scenario. Separately and also of note, during the SARS epidemic, lower courts in Beijing and Guangdong issued judicial guidance instructing trial courts to strictly interpret the application of the force majeure doctrine, advising that the parties must have entered into the disputed contract before the epidemic arose (otherwise, its effects would not have been unforeseeable), and that if the epidemic's supervening effects come into effect after an inexcusable delay, this also should not qualify.

- In recent U.S. legal history, one of the more memorable instances when force majeure claims have been upheld was following the September 11 attacks in 2001, which led to a two-day suspension of civil air flights across American airspace. Contractual duties slated for performance during that period and that depended on air flights were exempted.

III. Options Available to Businesses

An overview of the generic options available to business affected by the epidemic and its shutdowns is as follows:

- When encountering impossibility of performance as a Chinese business, or a force majeure declaration as a foreign business, analyze your relevant contract's governing law and forum selection clauses; the controlling body of law and location for any future litigation on this topic may be particularly relevant to a party's likelihood of success in advancing or opposing a force majeure claim.
- For Chinese businesses, you should notify foreign counterparties of any circumstances that prevent performance, and at the same time seek to document or otherwise collect proof of these circumstances. During communications with counterparties, it is recommended that attempts also be made to strike up agreed delays or cancellations. Chinese businesses should also be wary not to rely too heavily on the prospect of excusal if circumstances leading up to difficulty were under your control—in that scenario, it may be better to attempt to strike an agreed contractual modification, or seek advice on other potentially applicable legal doctrines.
- One of the best options for foreign companies affected by the epidemic may be to reach out to a supplier or purchaser in China, and to attempt to negotiate with them to grant priority once business has resumed.
- All affected businesses should review their current commercial situation and consider changes in business strategy to reduce or hedge exposure, price in the risks posed, and potentially offload current contractual rights/duties to willing third-party buyers at discounted prices. This is especially so because concerns have been raised about how long the impact on business will last, with some observers predicting that the impact of the epidemic could last for several months—as many migrant workers remain unable or reluctant to return to their factories or worksites, thereby impacting production.
- Businesses should also review any applicable insurance policies to see whether they might cover any losses or damages for flow-on breaches to downstream contracts.
- Going forward, though force majeure clauses are typically among the least scrutinized during contract drafting, businesses likely affected by the ongoing effects of the epidemic should ensure that specific language is included in any new contracts to address interruptions to their deals.

IV. Quinn Emanuel's Transnational Litigation & Arbitration Practices

Quinn Emanuel has a great depth of experience and a strong history of success in representing clients in cross-border commercial litigation and arbitration, especially those relating to Chinese parties. In addition to our U.S. offices which are located at or near the principal forums of business litigation in the

United States, we maintain offices in Shanghai and Hong Kong, and we have offices strategically positioned across Europe and Australia. Our core China team are bilingual, and have a wealth of experience in China as well as multiple jurisdictions abroad. Our principal litigators and attorney teams are among the finest in the world, and routinely work together across multiple languages, cultures, and time zones. Recent examples of our China-related litigation practice include:

- In January of this year, we won a major victory in federal court in New York for five Chinese banks. The underlying dispute related to a trademark infringement class action which Nike had won in 2013 against online sellers of counterfeit shoes and apparel. Nike then sold that judgment to an investment-backed special purpose vehicle (“SPV”), which created the issue that we were called in to resolve: the SPV tried to enforce injunctive relief under the judgment against payment platforms and banks that were allegedly facilitating the infringement, in particular by submitting almost impossible discovery and cooperation requests that appeared designed to trigger contempt proceedings and thereby permit the award of sanctions. After being brought into the case one month out from a sanctions hearing, we managed to defeat the SPV’s claims, persuading the court that the SPV’s case was “wrong on facts, contrary to law, and unworkable as a matter of public policy,” thereby saving the banks from \$130 million in threatened sanctions.
- We also recently represented a start-up electric car manufacturer in emergency arbitration against one of China’s largest real estate companies, which had promised \$2 billion in financing to our client, but after contributing \$800 million, then reneged on the next instalment of \$300 million, while still retaining a veto power against our client’s obtaining alternative financing. To save our client from insolvency, thereby triggering a change of control, we filed an arbitration in Hong Kong with a petition to void the whole \$2 billion transaction, on grounds that the financier had repudiated the entire financing agreement. This submission was accepted, and we won a complete victory for our client, along with the vast majority of our legal fees and costs. The parties later entered into a confidential settlement.
- Previously, we also represented one of China’s leading digital media groups in a London-based arbitration against an African national government, relating to that government’s purported termination of a contract to roll out communications infrastructure. In this matter we were able to secure a strong settlement for our client that involved revival of its contract. Similarly, in a separate arbitration matter, this time against a Chinese firm, we won a complete victory for a leading Asia-focused private equity fund in proceedings based in Hong Kong, denying requests by a Chinese investment firm for highly confidential information.

If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

Sam Williamson

Email: samwilliamson@quinnemanuel.com

Phone: +1 212 849 7455

Xiao Liu

Email: xiaoliu@quinnemanuel.com

Phone: +86 21 3401 8766

To view more memoranda, please visit www.quinnemanuel.com/the-firm/publications/