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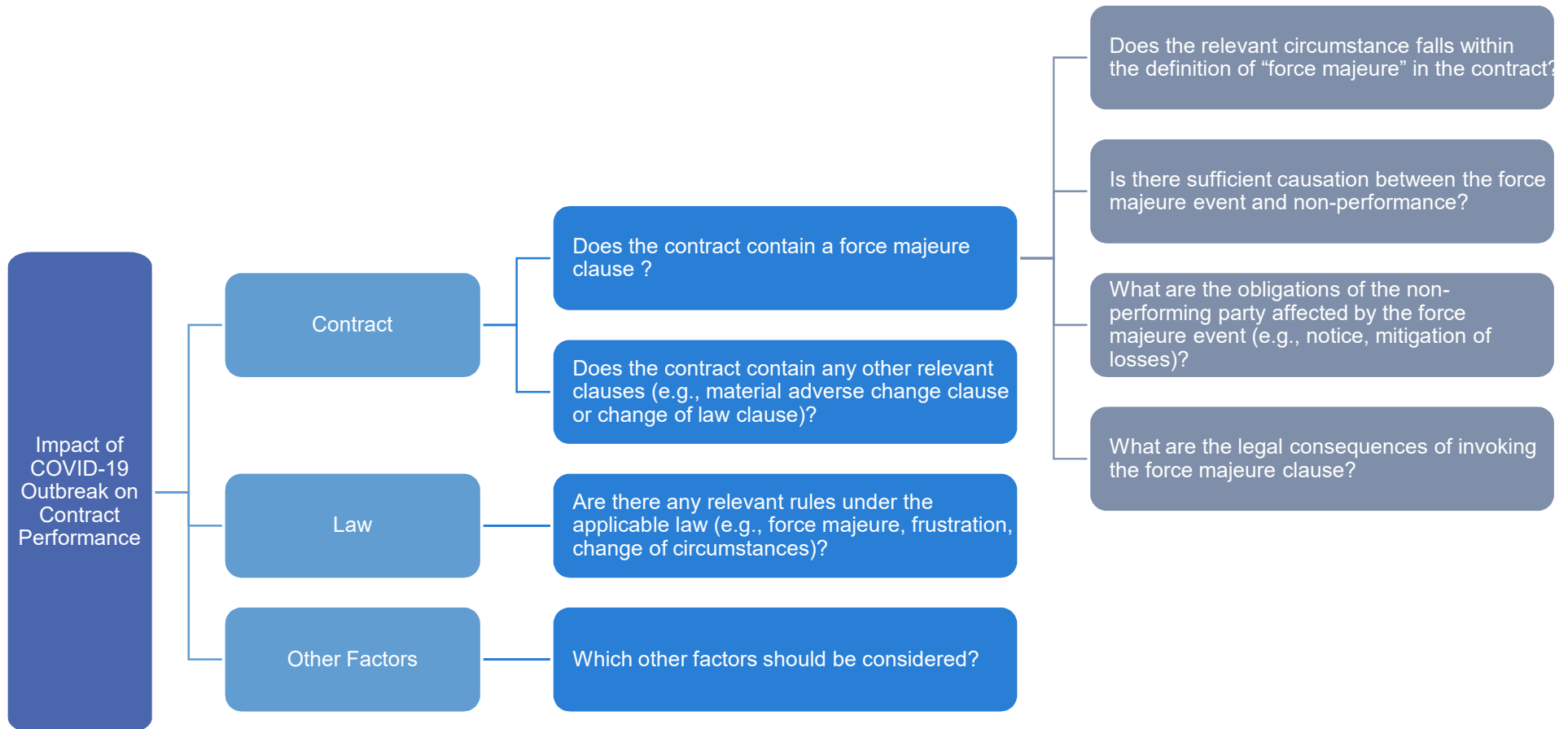
高伟绅律师事务所



**COVID-19 OUTBREAK AND ITS IMPACT ON CONTRACT PERFORMANCE:
A PRACTICAL GUIDE**

Clifford Chance LLP
February 2020

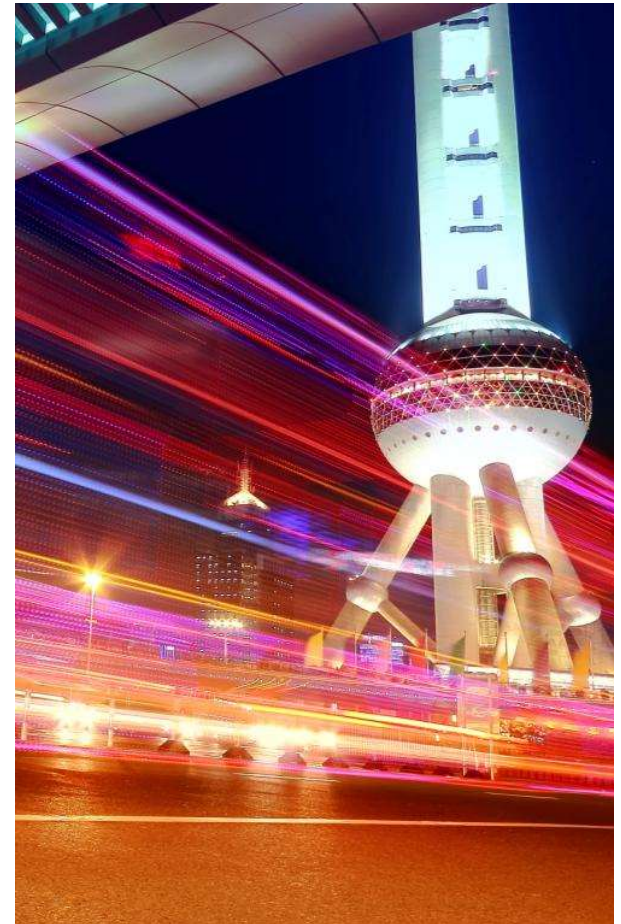
OUTLINE



The information in this presentation is based on general analysis of commercial contracts and is subject to the governing law of the relevant contract and does not constitute legal advice. Any content relating to the PRC is based on our experience as international counsel representing clients in business activities in the PRC and should not be construed as constituting a legal opinion on the application of PRC law. As is the case for all international law firms with offices in the PRC, whilst we are authorised to provide information concerning the effect of the Chinese legal environment, we are not permitted to engage in Chinese legal affairs. Our employees who have PRC legal professional qualification certificates are currently not PRC practising lawyers.

CONTRACT – FORCE MAJEURE CLAUSE: OVERVIEW

- Force majeure clauses can be found in many international commercial agreements.
- Analysis of force majeure clauses should be made in light of the applicable law.
- Four key questions need to be considered when analysing whether and how the force majeure clause applies:
 - Does the circumstance fall within the definition of "force majeure" in the contract?
 - Is there sufficient causation between the force majeure event and the non-performance of the contract?
 - What are the obligations of the non-performing party affected by the force majeure event?
 - What are the legal consequences of invoking the force majeure clause?



CONTRACT – FORCE MAJEURE CLAUSE (1): DOES THE CIRCUMSTANCE FALL WITHIN THE DEFINITION OF “FORCE MAJEURE” IN THE CONTRACT?

- Does the definition of “force majeure” expressly refer to epidemic outbreak?
 - Some force majeure clauses contain a list of circumstances constituting force majeure, which may include epidemic, plague/pestilence etc.
 - Even if epidemic outbreak is one of the enumerated examples in the force majeure clause, it should be analysed whether a particular epidemic outbreak satisfies general requirements under the contractual definition of “force majeure” (e.g., whether it is unforeseeable and impedes the performance of the contract) .
 - In contrast, even if the list of force majeure events specified in the contract does not expressly include epidemic outbreak, it does not necessarily mean that epidemic outbreak does not qualify as “force majeure”. The following questions need to be further considered.
- Does the force majeure clause cover other circumstances triggered by the epidemic outbreak?
 - For example, the list of force majeure events in the contract may include “government order” or “government interference”. Therefore, actions taken by the government in response to the epidemic outbreak (e.g., orders to extend holidays or travel restrictions) may constitute a force majeure event.
- Does the general definition of “force majeure” under the contract cover the epidemic-related events?
 - Some contracts may not enumerate the circumstances constituting “force majeure”; instead they would provide a general definition of “force majeure” (e.g., “objective circumstances that are unforeseeable, unavoidable and insurmountable”).
 - Some contracts, in addition to the list of enumerated examples, may also state that such list is non-exhaustive (using language such as “including but not limited to”) and further include a general descriptive definition of “force majeure”.
 - Under those circumstances, it should be analysed whether the epidemic-related events fall within the general descriptive definition of “force majeure” based on the contractual terms and the governing law.

CONTRACT – FORCE MAJEURE CLAUSE(2): IS THERE SUFFICIENT CAUSATION BETWEEN THE FORCE MAJEURE EVENT AND NON-PERFORMANCE?

- From contractual perspective, what does the force majeure clause say about (i) the impact of the force majeure event on contract performance and (ii) the requisite causation?
 - Different contracts may adopt different standards on the extent of impact on contract performance that would trigger the force majeure clause.
 - Some contracts require a high threshold (e.g., that the force majeure event renders performance impossible, or the contract is unable to be performed despite the party's best efforts) .
 - Others require a relatively low threshold (e.g., that the force majeure event causes delay in performance or the party is unable to perform the contract despite of its reasonable efforts) .
 - Sufficient causation between the force majeure event and non-performance is also usually required.
 - A force majeure event may have different impact on different contractual obligations. For example, a simple obligation to pay is usually considered less likely to be affected by a force majeure event.
 - If the non-performance is caused jointly by a force majeure event and the act of the defaulting party, then the defaulting party's ability to rely on the force majeure clause may be undermined.
 - Contracts may also provide for the requisite causation between non-performance and the force majeure event (e.g., whether the contract limits the application of the force majeure clause to the situations that the non-performance is caused directly by a force majeure event, or whether it covers both direct and indirect causation.)
 - Causation may also affect the starting time and ending time of a force majeure event.
- From factual perspective, does the impact on contract performance and causation meet the contractual requirements?
 - Companies which intend to invoke force majeure clauses should actively collect evidence of the existence of the force majeure event and its impact on contract performance.
 - The factual certificates issued by the relevant authorities usually only prove the existence of certain events (e.g., the existence of public health emergencies, or government orders that require businesses to remain shut), which are usually not sufficient to prove that such event constitutes “force majeure” under the contract or that the force majeure event has impeded contract performance. Therefore, companies need to collect more evidence by themselves.

CONTRACT – FORCE MAJEURE CLAUSE (3): WHAT ARE THE OBLIGATIONS OF THE NON-PERFORMING PARTY AFFECTED BY THE FORCE MAJEURE EVENT?

- Obligation to notify
 - Force majeure clauses usually require that the party affected by the force majeure event timely notify the other parties.
 - Key aspects of notification obligation:
 - Timing of notice (e.g., whether the notice needs to be given as soon as possible, within reasonable time, or within time period as specifically agreed in the contract?)
 - Form of notice (e.g., delivery method, recipient, language, and format)
 - Content of notice (i.e., what information needs to be included, whether evidence should be provided, and if so, when?)
 - Whether there is a continuing obligation to notify
 - What are the consequences for failing to comply with the notification obligation
- Obligation to mitigate losses
 - Some contracts may require that the party affected by the force majeure event mitigate losses caused by the force majeure event.
 - The extent of such obligation varies in different contracts (e.g., reasonable efforts or best efforts?)
 - Companies should actively collect evidence to show that it has fulfilled its obligation to mitigate losses.
- Subject to the contractual terms, failure by the affected party to satisfy such obligations might result in the party being unable to invoke the force majeure clause or being liable for the losses caused by its failure.

CONTRACT – FORCE MAJEURE CLAUSE (4): WHAT ARE THE LEGAL CONSEQUENCES OF INVOKING THE FORCE MAJEURE CLAUSE?

Contracts often provide for one or more of the following consequences

Suspension of performance / extension of performance period (until end of the force majeure event)

Termination of contract (usually only when the force majeure event lasts for a long period of time or performance of the contract is fundamentally affected by such force majeure event)

Good faith re-negotiation / consultation (open-ended solution)



CONTRACT – DOES THE CONTRACT CONTAIN ANY OTHER RELEVANT CLAUSES?

Material Adverse Change Clause

- In M&A transactions, material adverse change clause is usually a condition upon which the buyer is allowed to walk away.
- In facility/loan transactions, material adverse change may trigger draw stop or default.
- Based on commonly seen material adverse change clauses, the epidemic *per se* might not necessarily constitute material adverse change, but the impact on the company's commercial and financial status caused by the epidemic might constitute material adverse change.

Change of Law Clause

- Change of law clauses are often seen in long-term supply contracts, which might trigger re-negotiation mechanism or the right to terminate the contract.
- Whether the government orders in relation to this epidemic constitute "change of law" depends on the specific terms of the contract.

Hardship Clause

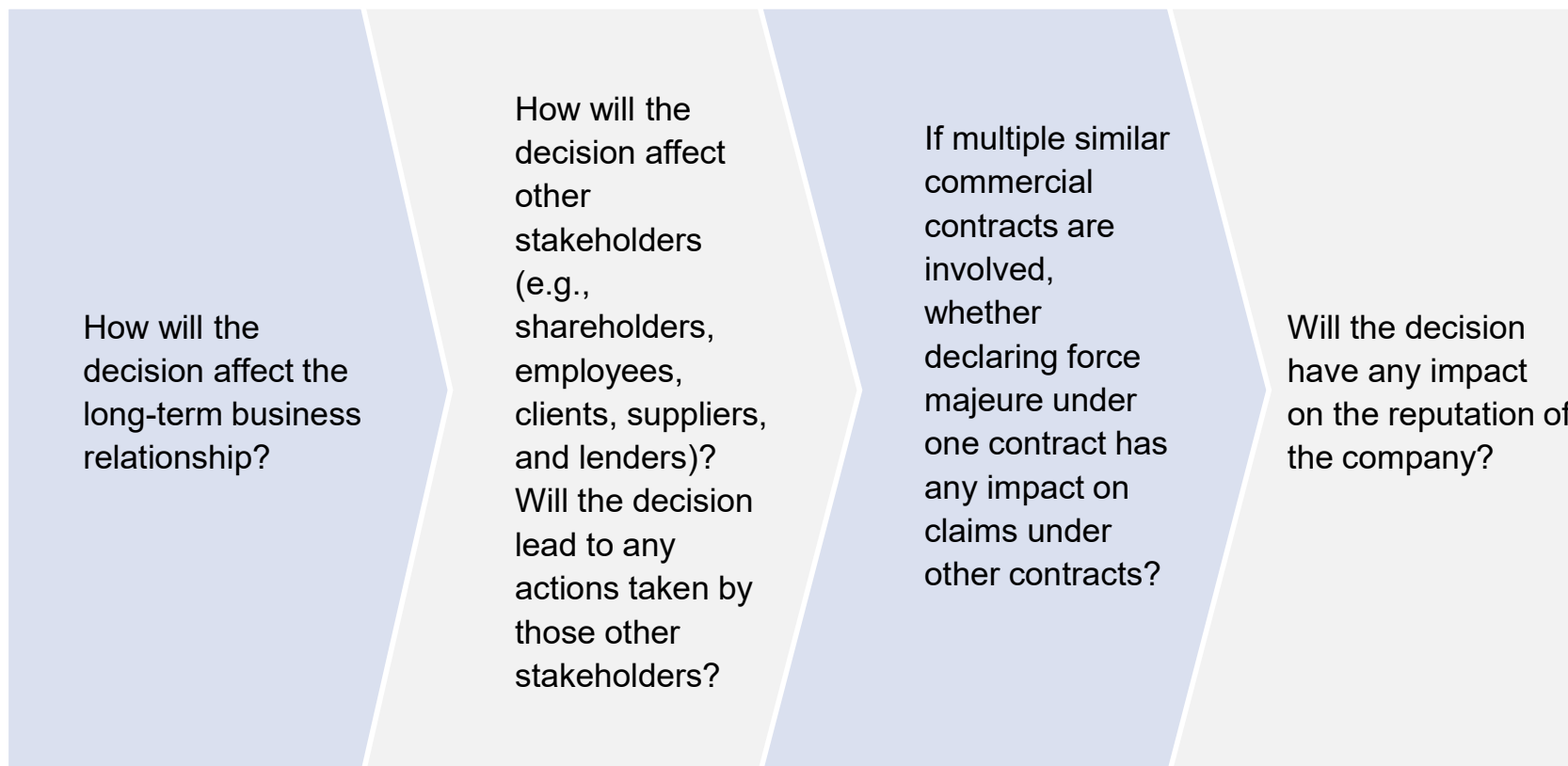
- Hardship clause is similar to force majeure clause, with the main difference being that the threshold for applying hardship clause is generally lower (e.g., applicable to situation where as a result of certain events, performance of the contract becomes more onerous than that reasonably expected, but is not impossible).
- Legal consequences of triggering hardship clause depend on specific terms agreed in the contract (e.g., extension of performance period, termination of performance or re-negotiation).

LAW – ARE THERE ANY RELEVANT RULES UNDER THE APPLICABLE LAW?

- If the contract does not contain a force majeure clause or other similar clauses, it is necessary to consider whether there are any relevant rules under the law applicable to the contract.
- Common Law Jurisdictions
 - Common law jurisdictions usually do not have established rules on force majeure in absence of contractual provisions. Doctrines of similar effect include "frustration" (under English, Hong Kong and Singapore laws) and "impossibility/ commercial impracticability" (under the US law).
 - The threshold for applying the doctrine of "frustration" or "impossibility/ commercial impracticability" is usually high.
 - The event must be without fault of either party, unforeseeable by the parties when concluding the contract, and result in a radical change of the contractual obligation.
 - For example, if the event causes one-month delay, it may constitute a radical change of a contract without outstanding term of one month, but not for a contract with outstanding term of several years.
 - In the absence of a force majeure clause in the contract, courts and arbitral tribunals are usually very cautious in directly applying the doctrine of "frustration" or "impossibility/commercial impracticability" to discharge parties from a contract.
- Civil Law Jurisdictions
 - Many countries in civil law jurisdictions adopt statutory rules on force majeure, change of circumstances or alike.
 - Different countries adopt different approaches on definition of force majeure / change of circumstances and their legal consequences.
 - Statutory rules are supplemental to contractual agreements. If force majeure or similar clauses are expressly provided for in the contract, the contractual agreements should usually prevail.

OTHER FACTORS – WHICH OTHER FACTORS SHOULD BE CONSIDERED?

When considering whether to declare force majeure or to allow the other party to declare force majeure or to raise a similar defence as a result of the epidemic outbreak, one should consider not only the contractual agreements and legal principles, but also commercial, reputational and other factors.



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