Managing the impact of the COVID-19 pandemic on IP contracts governed by Chinese law: the SPC’s Guiding Opinion on force majeure

Guiding Opinion on the Handling of Civil Cases Affected by the COVID-19 Outbreak (16 April 2020) 1

The Chinese Supreme People’s Court has issued guidance for the lower courts relating to the application of force majeure in cases of failure to perform a contract due to the COVID-19 outbreak.

Legal context and facts

The current COVID-19 pandemic and the measures taken by public authorities to control it have been causing disruptions across all sectors of society. Many businesses have been prevented from performing their contractual obligations by obstacles of a factual or legal nature related to the pandemic, such as lockdown orders, disruptions in travel and import or export bans.

When it comes to IP-related contracts, these effects have been equally disruptive. Licences often contain provisions for the payment of royalties, or other obligations such as minimum purchases or sales, which may become difficult to fulfil in a highly unsettled business environment. Companies may also find it more difficult, in the current situation, to ensure certain standards of security and confidentiality that also depend upon, or involve, third parties or sub-contractors affected by the pandemic.

At the outset of the outbreak, many studies looked into the question of whether, given the unprecedented impact of the COVID-19 outbreak, failure to perform one or more obligations under a contract could be excused by either a force majeure clause or, if absent, any other doctrine available under the law governing the contract.

Later into the pandemic, when the scale of its impact on business activities became clear, some lawmakers enacted ad hoc legislation to counter the gravest effects on some types of contracts, such as consumer loans and mortgages. Some jurisdictions, such as in Italy and China, started issuing ‘force majeure certificates’, which companies would be able to use to sustain a claim to excuse their non-performance.

China has been ahead in the pandemic on both the public health and the legal fronts. As the first jurisdiction in which the social and economic effects of the disease have been felt, early on China implemented different measures to support contractual parties and business in general. In late January and early February 2020, the Chinese authorities allowed the suspension of trade mark filing terms, put in place virtual hearings, and provided for economic support to companies affected by the outbreak.

China was also one of the first jurisdictions to clarify the extent to which the pandemic and the measures implemented by governments to contain it could fulfil the requirements of force majeure to excuse non-performance. On 20 April 2020, the Supreme People’s Court (SPC) issued a Guiding Opinion on the Handling of Civil Cases Affected by the COVID-19 Outbreak (the ‘Opinion’). In the Chinese legal order, this type of opinion is binding on the lower courts and the SPC itself. While the Opinion touches upon different aspects of civil cases, the present note focuses on the application of force majeure to excuse a failure to perform a contractual duty.

Analysis

In summary, the Opinion confirms that the Chinese regime of force majeure applies in contractual relationships affected by the outbreak or by the measures taken by public authorities to contain it and guides courts in handling disputes related to cases of alleged force majeure.

The Opinion is grounded in the Chinese statutory regime of force majeure, which comprises three provisions. Article 180 of the General Principles of Civil Law lays down the principle that if a party is unable to perform an obligation of civil nature due to force majeure, they shall not bear civil liability. The same provision defines force majeure as an ‘objective situation’ which is ‘unforeseeable, unavoidable and insurmountable’. Article 117 of the Contract Law applies the same principles to contracts, clarifying that the excuse for failure to perform may be partial or total, according to the impact of the event of force majeure. Where an event of force majeure occurred after the party’s delay in performance, they may not be exempted from liability.

The Opinion clarifies that, if the statutory conditions are met, force majeure constitutes a ground to uphold either a request for termination or a request to excuse a failure to perform a contract. Termination may only be allowed in case the outbreak or the curbing measures have rendered performance impossible. According to the Opinion, if the purpose of the contract can no longer be realized, the parties may request the termination of the contract and the courts will uphold such a request.
If the outbreak or the measures implemented to contain it only cause difficulties in performing the contract, and not a full failure, the parties may renegotiate, and the courts shall strengthen mediation as an alternative dispute resolution method. Other similar methods, such as arbitration, may come into play in these cases. The Opinion also provides that whenever performance is still possible, the courts would not uphold a request for termination. In assessing when a contract can still be performed, the courts will look at the circumstances of the case and also take into account if one or more parties received government subsidies, tax relief or other types of funding related to the outbreak.

The Opinion also leaves some room for the application of the doctrine of change of circumstances. If the continued performance of the contract is still possible, but unfair to one party, and if that party requests a change in the contractual arrangements, the courts will decide whether to support the request in light of the actual circumstances of the case.

The Opinion specifies that the party relying on force majeure shall timely notify it to the other party, according to the law. In addition, the party claiming partial or total exemption from liability bears the burden of proof with respect to establishing (i) the existence of the force majeure event and (ii) that such event directly resulted in the partial or total non-performance of their contractual obligations.

The Opinion gives some guidance as to the practical application of the latter requirement. The courts shall assess the causal link between the pandemic or the curbing measures and the party’s failure to perform the contract against the backdrop of its impact on different regions, industries and on a case-by-case basis. Liability may be partially or completely excluded based on the degree of impact of the outbreak.

Practical significance

The Opinion is certainly a welcome support for parties and their counsels in assessing the best way forward in cases involving contracts governed by Chinese law and affected by the pandemic. It makes the application of force majeure more predictable at the outset of a dispute, which may encourage parties to negotiate, settle or choose an effective alternative dispute resolution method, such as mediation or arbitration.

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