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CROSS-BORDER TRANSACTIONS CAUGHT AT THE CROSSROADS: NAVIGATING THE GLOBAL COVID-19 CRISIS THROUGH FORCE MAJEURE PROVISIONS

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The coronavirus (COVID-19) pandemic has had sweeping effects around the world, and in this era of globalization, business transactions that span multiple jurisdictions and markets have fallen prey to new and unexpected risks presented by the pandemic. In this highly uncertain business climate, how should multinational companies be negotiating new commercial agreements and addressing these risks through force majeure provisions?

This White Paper explores some key issues for international businesses to keep in mind as they tread uncharted waters during the COVID-19 pandemic, focusing on force majeure provisions that may forgive contractual performance. The phrase "force majeure" comes from the French language and means "superior force" that can be neither anticipated nor controlled. A force majeure provision is used for "allocating the risk of loss if performance becomes impossible or impracticable, especially as a result of an event or effect that the parties could not have anticipated or controlled."[1]

This White Paper first provides some updates on the business environment in major markets, in particular the United States, the United Kingdom, the People's Republic of China, and Japan, and proffers a general overview on how force majeure provisions in contracts may be interpreted, and where there are no force majeure provisions negotiated in advance, under applicable law in these jurisdictions.

In light of the current COVID-19 pandemic, we also discuss key issues that multinational companies should consider in negotiating and entering into new commercial agreements and preparing for future unexpected events that may make contractual performance difficult or impossible.

UNITED STATES OF AMERICA

Update on Business Environment in the United States[2]

On March 13, 2020, US President Donald Trump declared a national emergency because of the COVID-19 outbreak in the United States. The number of COVID-19 cases continues to climb throughout the United States, and the United States has now surpassed China in the number of reported COVID-19 infections and deaths. New York, New Jersey, Pennsylvania, Massachusetts, Illinois, Michigan, California, Washington, Texas, Florida, and Louisiana are among the states hardest hit by the COVID-19 pandemic.

In populous metropolitan areas such as New York City, Los Angeles, and Chicago, stay-at-home or shelter-in-place orders have forced most everyone to remain at home and exercise social distancing from each other, which has led to widespread cancellations of meetings, events, and business trips. These prohibitions against social gatherings and limitations on human interaction have had a widespread adverse impact on US businesses, especially those operating in the hospitality, transportation, entertainment, retail, and tourism industries.

Many businesses have been unable to deliver goods and render services in the ordinary course, and they worry that they may be in breach of their contractual obligations or that the other party to their agreements may renege or fail to perform, entirely or partially, their contractual obligations. Any such

[1] *Black's Law Dictionary*, 718 (9th ed. 2009).

[2] Special thanks to Robert Brochin for his invaluable comments and guidance in the US section of this article. Robert is a member of Morgan Lewis's Force Majeure Task Force and an experienced trial lawyer who handles litigation and disputes involving force majeure issues.

failure to satisfy contractual obligations can have reverberating effects. If a contract to deliver goods and supplies cannot be performed, the lack of goods and supplies under one contract may result in an inability for the affected party to meet its obligations under other contracts.

General Overview of Force Majeure Law in the United States

In the United States, there are basically three legal sources that parties should consider when evaluating whether performance required by a contract can be excused or delayed upon an occurrence of an unexpected event that renders performance of the contract impossible or impracticable: first, the force majeure provision in the contract negotiated between the parties; second, the Uniform Commercial Code (UCC); and third, state common law principles.

First, through contract negotiations, the parties may agree how to allocate risks when an event out of their control, a force majeure event, occurs. Second, if the parties did not negotiate a force majeure provision in the contract or if the contract is ambiguous as to how risks are allocated between the parties when there is a force majeure event, the parties may look to the UCC, which is a uniform statute enacted in each of the states in the United States except for Louisiana, and in particular, Article 2 of the UCC, which applies to the sale and purchase of goods.[3] Third, if the contract is silent or ambiguous on force majeure events and if the UCC is not available, then the parties may rely on state common law principles to decipher under what circumstances contractual obligations may be excused.

Freedom of Contract

The parties engaged in business transactions may negotiate agreements that contain a "force majeure" provision. These provisions typically state that performance of contractual obligations can be excused or delayed when and to the extent that such nonperformance is caused by acts beyond the parties' reasonable control, including acts of God, flood, fire, earthquake, tsunami, lightning, war, terrorism, civil commotion or riot, civil unrest, armed hostilities, government order or action, embargo, strikes, lockouts, labor stoppage or other industrial disturbances, shortage of power or materials, network outage, failure of infrastructure, transport or supplies, nuclear accident, epidemics, pandemics, public health crisis, severe weather conditions, climate change, or other natural or manmade disasters.

In essence, these "force majeure" provisions that the parties can negotiate among themselves are a contractual tool to allocate risk between the parties. If performance of obligations under a negotiated agreement becomes impossible or impracticable due to certain defined events or events that the parties could not have anticipated or controlled, then the parties may agree to shift any risk of loss arising from those events to either one party or the other, or agree to mutually accept those risks. Whatever the parties intend in terms of risk allocation should be memorialized in the agreement between those parties.

For example, the parties may wish to agree in advance that if the seller of goods cannot complete delivery due to unexpected circumstances such as a global pandemic or government lockdown order, then the seller would be released from its duty to deliver and the buyer would assume the risks and costs of nondelivery. Alternatively, the parties may agree that if delivery cannot be completed due to those circumstances, the seller would need to bear the risks and costs by procuring substitute delivery. Through negotiated agreements and the freedom of contract, the parties may agree on any variation of risk allocation that they desire.

Force majeure provisions in negotiated agreements generally allow forbearance or forgiveness of contractual obligations by the party suffering from unanticipated force majeure events. The parties may agree on a precise list of force majeure events and specifically identify pandemics and government orders as force majeure events in an agreement. Depending on negotiations, however, the parties may favor a

[3] Uniform Commercial Code § 2-615(a) (Excuse by Failure of Presupposed Conditions). Article 2 of the UCC is limited to the sale and purchase of goods and does not apply to transactions involving services or real estate.

broader approach and decide to agree on a "catch-all" provision, defining a "Force Majeure Event" to mean any and all events outside of either party's control. While there are advantages to a "catch-all" approach, the downside is that courts may still require that the event forgiving contractual performance be "unforeseeable," and therefore, boilerplate general language may be inadequate.[4] For example, pandemics and stay-at-home or lockdown orders issued by governments may not be deemed "unforeseeable" given that multinational businesses have previously experienced these types of crises, including pandemics like SARS or MERS and lockdowns due to riots or political protests, such as those that we have been seeing recently in Hong Kong and the United States. Accordingly, it would be preferable to list with specificity those events that may excuse or delay performance along with the catch-all language because any catch-all language may create ambiguity.

Rather than leaving any disagreement to the courts to decide, businesses should negotiate force majeure provisions in advance to allocate unknown risks between the parties. In general, courts in the United States desire to enforce contracts and will determine the intent of the parties in negotiating these provisions such that the court can understand and enforce the parties' contract. The freedom of parties to contract and have courts enforce those contracts is a fundamental tenet of economic relations and liberty in the United States.[5]

Uniform Commercial Code

If force majeure provisions are not in an agreement between the parties, the parties should consider whether the UCC may apply when a force majeure event emerges. The UCC is often referred to as "the backbone of American commerce" because the statutory scheme is aimed at promoting interstate business and commercial transactions throughout the United States and facilitating uniform application of commercial law from state to state.[6]

The doctrine of force majeure is codified in Section 2-615 of the UCC, which allows sellers of goods to avoid performance of contractual obligations where a delay in delivery or a partial or complete failure to deliver has been made "impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid."[7]

The first question under the UCC is whether an event preventing the seller's performance was "a contingency the non-occurrence of which was a basic assumption on which the contract was made."[8] This question revolves around whether the contingency was foreseeable at the time that the parties entered into the agreement.[9] A totally unexpected contingency is a factor weighing heavily in favor of excusing contractual performance. On the other hand, if the contingency should have been expected by

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[4] *Watson Labs., Inc. v. Rhone-Poulenc Rorer, Inc.*, 178 F. Supp. 2d 1099 (C.D. Cal. 2001).

[5] *See, e.g.*, Slaughterhouse cases, 83 U.S. 36 (1873); *Allgeyer et al. v. State of Louisiana*, 165 U.S. 578 (1897) (holding that "[t]he liberty mentioned in that [Fourteenth] amendment means not only the right of the citizen to be free from the mere physical restraint of his person, as by incarceration, but the term is deemed to embrace the right of the citizen to be free in the enjoyment of all his faculties; to be free to use them in all lawful ways; to live and work where he will; to earn his livelihood by any lawful calling; to pursue any livelihood or avocation, and *for that purpose to enter into all contracts which may be proper, necessary and essential to his carrying out to a successful conclusion the purposes above mentioned*." (emphasis added)).

[6] Uniform Law Commission.

[7] Uniform Commercial Code § 2-615(a) (Excuse by Failure of Presupposed Conditions). It is usually the seller of goods that invokes force majeure provisions, but these protections under the UCC may also be available to buyers under certain circumstances. *See, e.g.*, Comment 9 to Uniform Commercial Code § 2-615(a).

[8] *Cliffstar Corp. v. Riverbend Prods., Inc.*, 750 F. Supp. 81, 84 (W.D.N.Y. 1990).

[9] N.Y.U.C.C. Section 2-615(a); *Cliffstar Corp. v. Riverbend Prods., Inc.*, 750 F. Supp. 81, 84 (W.D.N.Y. 1990).

the parties at the time of contract, then the contingency and its consequences are taken outside the scope of the UCC and Section 2-615 may not apply because the seller could have protected itself by including a well-crafted force majeure provision in the contract.[10]

Even if the contingency was unexpected and seller is excused from performance, the UCC imposes a duty on the seller to promptly notify the buyer that there will be a delay or nondelivery.[11] If the seller is able to fulfill some, but not all, of the buyer's order, then the UCC authorizes the seller to allocate production and delivery among customers as long as the allocation is "fair and reasonable."[12] Although the UCC does not define what would be considered "fair and reasonable," the UCC urges sellers to exercise "extra care" in making the allocations, but leaves "every reasonable business leeway to the seller."[13]

Under the UCC, increased costs or other economic factors may not suffice to excuse prompt delivery under an agreement for sale and purchase of goods.[14] For example, in a case interpreting the application of UCC Section 2-615, the court did not relieve the afflicted party from its obligations under a fixed price agreement to deliver milk to a school where there was substantial increase in the price of milk because the price increase was "not totally unexpected."[15] Unless the cost increase was due to an unexpected contingency that fundamentally "alters the essential nature of the performance" contemplated by the contract, the UCC will require the seller to fully perform its delivery obligations.[16]

Common Law

If the agreement between the parties is silent when a force majeure event arises, and if the UCC is not available,[17] then the parties may consider the common law doctrine of impossibility or impracticability of performance of frustration of purpose.

The United States consists of 50 different states, a federal district (Washington, DC), and some territories and small islands. Courts in each state or district have jurisdiction over contract dispute cases, and they develop common law applicable to that state. The state law that will apply in almost any given situation may be agreed to by the parties, e.g., the parties stipulate that the law of California will apply to their contract. In the absence of a governing law provision in the agreement, the court will consider various factors to determine which state law applies, e.g., where the contract was negotiated, where the contract is to be performed or was breached, where the parties reside or conduct their business, and other factors.

While a survey of each state's common law is beyond the scope of this article, we will outline at a high level how force majeure events such as pandemics and government orders may discharge a party from its existing contractual obligations under state common law. Under state common law, the doctrine of impossibility or impracticability of performance or frustration of purpose will apply generally to determine

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[10] *Cliffstar Corp.*, 750 F. Supp. 81, 84 (W.D. N.Y. 1990) (citing *Eastern Air Lines v. Gulf Oil Corp.*, 415 F. Supp. 429, 438 (S.D. Fla. 1975).

[11] Uniform Commercial Code § 2-615(c).

[12] Uniform Commercial Code § 2-615(b).

[13] Comment 11 to Uniform Commercial Code § 2-615.

[14] Comment 4 to Uniform Commercial Code § 2-615 ("Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover.").

[15] *Maple Farms Inc. v. City School Dist. of City of Elmira*, 352 N.Y.S.2d 784 (N.Y. Sup. Ct. 1974).

[16] Comment 4 to Uniform Commercial Code § 2-615 ("Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance.").

[17] For example, the UCC may not be available where an agreement provides for performance of services rather than sale of goods.

whether contractual obligations can be excused. This analysis is factually intensive and should consider the particular facts and circumstances causing the nonperformance or delay, including the industry in which the parties operate, the nature of the goods or services at issue (for example, whether the goods are perishable or scarce), shipping or delivery method, and many other factual and equitable variables.

The occurrence of an unanticipated event may make contractual obligations impossible or impracticable to perform or may frustrate the very purpose of the contract. The doctrine of impossibility "refers to those factual situations, too numerous to catalog, where the purposes for which the contract was made, have, on one side, become impossible to perform."[18] Under the doctrine of commercial impracticability, a court may relieve a party of its contractual duty "if performance has unexpectedly become impracticable as a result of a supervening event."[19] Even if performance is possible or practicable, the doctrine of frustration of purpose may discharge contractual duties if "the reason the parties entered into the agreement has been frustrated by a supervening circumstance that was not anticipated, such that the value of the performance by the party standing on the contract is substantially destroyed."[20] Some states combine these doctrines under the "rubric of impossibility."[21]

Whether these common law doctrines will discharge a party from contractual performance depends on the facts and circumstances of the situation, and therefore, the analysis is highly fact intensive and will be conducted on a case-by-case basis. Overall, courts are "reluctant to excuse performance that is not impossible but merely inconvenient, profitless."[22] Further, unless performance of an agreement becomes a sheer impossibility due to unanticipated events, performance will not be excused.[23] In other words, performance will be excused only under extreme circumstances where the performance becomes objectively impossible, for example, complete destruction or loss of the goods to be delivered under an agreement, and those extreme circumstances must have been unanticipated and unforeseeable.[24]

Additionally, under general common law principles, the unforeseen event preventing a party from performing under an agreement must have been the proximate cause of the failure to perform, and if there is no direct link between the event and the failure to perform, the nonperforming party may still be legally obligated to fully perform its contractual obligations.[25] In the current predicament, the COVID-19 outbreak or the related government orders to shut down businesses as a result of COVID-19 must be the proximate cause and true reason for not being able to deliver goods or render services. If the failure to deliver goods or render services is attributed to a different cause or reason, for example, rising prices, supply shortage or labor strife, the affected party will not be able to rely on the COVID-19 pandemic or ensuing government orders as a pretext for avoiding its contractual obligations.[26]

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[18] *Kamel v. Kenco/Oaks at Boca Raton LP*, 321 F. App'x 807, 810 (11th Cir. 2008).

[19] Restatement 2d. Contracts § 261, cmt. a.

[20] *Habitat Tr. for Wildlife, Inc. v. City of Rancho Cucamonga*, 175 Cal. App. 4th 1306, 1336 (2009). *See also* Restatement 2d. Contracts § 265 (Discharge by Supervening Frustration), cmt. a. (discussing "the problem that arises when a change in circumstances makes one party's performance virtually worthless to the other, frustrating his purpose in making the contract").

[21] *LSREF2 Baron, LLC v. Beemer & Assocs. XLVII, L.L.C.*, No. 3:10-CV-576-J-32JBT, 2011 WL 6838047, at *3 (M.D. Fla. 2011).

[22] *Elof Hansson Paper & Bd., Inc. v. Caldera*, No. 11-20495-CV, 2012 WL 12865853, at *8 (S.D. Fla. 2012) (internal citation omitted).

[23] *407 E. 61st Garage v. Savoy Fifth Ave. Corp.*, 23 N.Y.2d 275, 244 N.E.2d 37, 296 N.Y.S.2d 338 (N.Y. Ct. App. 1968).

[24] *See, e.g.*, *Kel Kim Corp.*, 70 N.Y.2d 900, 902; *Interpetrol Bermuda v. Kaiser Aluminum Int'l*, 719 F.2d 992 (9th Cir. 1983, amended 1984).

[25] *Hong Kong Islands Line Am. S.A. v. Distribution Servs. Ltd.*, 795 F. Supp. 983, 989 (C.D. Cal. 1991), *aff'd*, 963 F. 2d 378 (9th Cir. 1992) (applying California law).

[26] *Id.*

Practical Tips

Negotiating business agreements to address future unknown risks is vital for business success. Businesses need predictability and visibility in their commercial transactions, especially at a time when a global pandemic is uprooting the way that business usually operates. Through contract negotiations and a precisely drafted force majeure provision, businesses can plan ahead for unforeseen future events by allocating risks between the parties on their own terms, which will provide more certainty for all parties.

If an agreement lacks a force majeure provision or if the force majeure provision is not precisely written, parties may look to the UCC for guidance. If the UCC is not available, then parties may refer to state common law to determine whether a party may be allowed to bypass its contractual obligations under certain unexpected circumstances. It is always better to take the matter into one's own hands and formulate a clear force majeure provision to prepare for future uncertainty.

Because there are some nuances in the way that state courts interpret force majeure provisions and those interpretations vary from state to state in the United States, consulting counsel who has expertise in force majeure law in a particular state that governs the agreement will be of tantamount importance to multinational businesses.

UNITED KINGDOM

Update on Business Environment in the United Kingdom

The United Kingdom entered full lockdown on March 23, 2020, with the UK government quick to introduce wide-ranging support schemes for businesses, including emergency financing provisions and support with staff wages such as the "furloughing" scheme—the Coronavirus Job Retention Scheme—which effectively places an employee on leave and covers 80% of the employee's salary (reducing from August 2020), and from which a quarter of the UK workforce is currently (as of June 2020) benefitting; it is intended to continue until the end of October 2020.

While the economy is clearly suffering a major contraction, some sectors more than others, the banking and finance system has continued to function with liquidity (unlike during the 2008–2009 financial crisis) and most businesses are surviving, and therefore the hope is that economic activity will quickly return to normal as restrictions are lifted. The economy is being reopened gradually, pursuant to a "conditional plan" based on the level of COVID-19 outbreaks in the country, although concerns about a potential "second wave" and long-term restrictions on activities, such as the use of public transport for anything other than essential travel, mean that a return to normal, or whatever the new normal will be, will take time.

General Overview of Force Majeure Law Under English Law

In respect of English law–governed agreements, an exogenous event such as COVID-19 would typically be considered in the light of the agreement's express force majeure provision, as well as other contract provisions that address situations which result in a material adverse effect on, or even the prevention of, the performance of one or more of the contract parties. In this section, we consider the most important of these contract provisions and how they are typically structured and applied.

If the agreement contains a force majeure clause, then English law will typically seek to apply and enforce the intent of the parties as evidenced by the clause. There is no statutory definition of force majeure (as there is in many civil code jurisdictions) nor does English law have a doctrine of force majeure. Under English law, the closest and most relevant doctrine is frustration; however, this doctrine is applied only on an exceptional basis by the English courts, and indeed if the parties have made express provision for the consequences of the particular event that has occurred, such as pursuant to a force

majeure clause, then the doctrine would not be applied.[27] In other words, in order to understand how a pandemic event affects the parties' arrangement, then the parties really have to look to their specific contract to understand their position.

Force Majeure Provisions in Agreements Governed by English Law

Force majeure clauses have developed over the years to follow a similar structure, although of course there are exceptions to the general rule. A typical formulation under English law is as follows:

- A definition of the force majeure clause "trigger," which will usually, in addition to a series of specific events (e.g. "pandemic") include a catch-all formulation along the lines of "an event reasonably outside the control of the parties"—although some clauses try to be exhaustive by listing all contractually permissible events.
- Contract performance being "prevented, hindered, or delayed."
- The nonperforming party is excused for the duration of the event and the impact it has on performance.
- After a period of time, the right for both or one of the parties (this can vary, but more usually the unaffected party) to terminate the agreement.

If the agreement contains a catch-all definition, then under English law, its meaning will be specific to the relevant contract, and the parties' intention when they entered into the contract or agreed to the relevant clause. In practice, this means that the same event could, from one agreement to the other, alternatively be considered or not considered a force majeure event, even with exactly the same contract drafting and with the same effect on the performing party. For example, a global pandemic might not be considered a force majeure event in respect of a contract that was specifically agreed for the provision of services in support of the recipient party in a global pandemic situation, whereas that same event would be considered force majeure event for a supply contract (e.g., for manufacturing parts).

In terms of the effect on performance, some force majeure clauses are restricted solely to prevention of performance, whereas a wider formulation clearly allows more scope for the affected party to raise performance issues. A key issue is that the event itself must be the cause of the nonperforming party seeking the relief of the clause,[28] and cannot be used as a pretext or as one factor among others, e.g., to avoid performance that it considers financially unattractive.

While performance is excused by the clause, there are usually provisions requiring the affected party to mitigate or take reasonable steps to minimize the effect of the event, and typically the English law doctrine of mitigation will apply in any event. In practice, therefore, it is important from a contractual perspective that the affected party continue to try to perform, notwithstanding the event itself, should it wish to rely on the protection of the clause.[29]

If there is a termination right, this will usually be triggered by a relatively long period of nonperformance or affected performance. One notable aspect of most English law force majeure clauses is that they do not expressly deal with the costs and losses to the parties arising from the event, even though the fallout from termination could be highly complex, with unrecovered, unamortized costs or losses for one or more of the parties, for example. The typical view in the event of such termination is that "costs and losses lie where they fall," which is to say that a force majeure–related termination will not result in a reallocation of costs; for example, payment from one party to another. This can clearly have a material impact on

[27] *Jackson v. Union Marine Insurance Co. Ltd.* (1874).

[28] *Intertradex v. Lesieur* (1978).

[29] *Channel Island Ferries Ltd v. Sealink UK Ltd.* (1987).

parties that have made significant investments in the relevant arrangement, and it may be advisable to include even a simple cost allocation provision in the agreement for a force majeure event.

The essential thing to remember about English law agreements is that unless the parties include provisions that address major force majeure–type events such as COVID-19, then English law itself will imply very few to almost no terms to the parties' agreement, and the parties' legal position vis à vis with each other will be highly uncertain.

PEOPLE'S REPUBLIC OF CHINA (PRC OR CHINA)

Update on Business Environment in China

Since late January 2020, the outbreak and accelerated spread of COVID-19 in China has led to the implementation of Major Public Health Emergencies Response Level I (the highest level) throughout the country. Accordingly, various administrative measures have been enacted by governmental authorities at both national and municipal levels since late January 2020 to control the spread of the virus.

The administrative measures include extended Spring Festival public holidays to postpone massive domestic travel of migrant workers returning to work; city lockdown or travel restrictions and a general 14-day self-assessed or institutionalized quarantine period for interprovincial or international travelers; the switch to online teaching for graded schools and higher education institutions; the promotion of working from home where possible; and other measures. Despite the highly controlled domestic situation and recent restarting of production, with the number of imported (i.e., from inbound international travelers) and asymptomatic cases on the rise, it remains uncertain whether the administrative measures will be totally lifted any time soon, or rather restrengthened.

The epidemic has greatly affected both Chinese exporters (suppliers) and importers (buyers). In March, a British budget fashion chain announced it would cancel all supplier orders that have not reached distribution centers. The company has about 40% of its products from China, and it is reported that the force majeure clause in the relevant agreements was invoked for the cancellation. Earlier in February, a Chinese liquefied natural gas buyer notified its European supplier that it would not be able to take delivery due to constraints caused by COVID-19 and requested excused contract performance based on force majeure rules.

General Overview of Force Majeure Law in the PRC

Under PRC law,[30] a party can be entitled to partial/overall exemption from its contractual liabilities or even termination of the contract to the extent it is not possible to perform the contract due to force majeure (i.e., the objective circumstances that are unforeseeable, unavoidable, and insurmountable),[31] regardless of whether there is an express force majeure clause in the contract. However, such party should timely notify the counterparty(ies), provide proof of the force majeure circumstances, and take appropriate measures to prevent further increase of losses.[32]

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[30] On May 28, 2020, PRC legislators voted to adopt the nation's first Civil Code (the Code), which has systematically incorporated existing civil laws and regulations specifically enacted over the years including (i) General Rules of the Civil Law of the PRC, (ii) General Principles of Civil Law of the PRC, (iii) PRC Contract Law, (iv) PRC Real Right Law, (v) PRC Guaranty Law, (vi) PRC Marriage Law, (vii) PRC Succession Law, (viii) PRC Adoption Law, and (ix) PRC Tort Liability Law. The Code will take effect on January 1, 2021, upon which the specifically enacted law and regulations in the foregoing shall be abolished. We have therefore indicated the new numbering in the Code of the relevant provisions quoted in this section as well as relevant changes and legal implications brought about by the enactment of the Code compared to the existing provisions (where applicable).

[31] Article 180 of the PRC General Rules of the Civil Law (Article 180 of the Code); Article 117 of the PRC Contract Law (Article 590 of the Code).

[32] Article 118 and Article 119 of the PRC Contract Law (Articles 590 and 591 of the Code).

In other words, the force majeure rules under PRC law require that (1) the existence of force majeure (the factual test), and (2) the causation between the force majeure event and the party's inability to perform the contract (the causation test) should be established; and that the affected party should not obtain inappropriate (e.g., exemption for losses that could have been prevented) or nonproportional (e.g., contract termination should only be awarded upon total failure of the purpose of the contract instead of partial inability to perform) gains through exercising the force majeure rules.

To support entities affected by COVID-19 in China to obtain performance exemption from their contract counterparties, the China Council for the Promotion of International Trade (CCPIT) has been issuing force majeure certificates since February 2020. It is reported that the CCPIT issued several force majeure certificates to enterprises invested by US and South Korean investors in March, and has been working on policy interpretation and problem solution references focusing on the Chinese enterprises invested by Japanese investors. It is also reported that more than 6,000 certificates have been issued as of March 25, 2020.

Regardless of these force majeure certificates, parties seeking performance exemption under force majeure should also focus on the causation test and, if there are multiple causes, carefully analyze the exact role and the extent of the impact of COVID-19 on its inability to perform the contract. In a case decided in 2013, the court ruled that since there lacked sufficient causation between the administrative measures (i.e., certain restrictions on restaurant operation) during the 2003 SARS epidemic (a recognized force majeure event) and the tenant's inability to perform the lease agreement of a hotel, the defendant was not entitled to terminate the lease using force majeure rules.[33]

In addition to force majeure, a party may also apply for the court to amend or terminate the contract at issue under the rules of "change of circumstances" if the continued contract performance would be obviously unfair for such party, or it becomes impossible to realize the goal of the contract in light of a significant change of the objective circumstances that was unforeseeable upon contract formation, and that is *neither* force majeure *nor* commercial risk, and the people's courts should decide the case following the principle of equality and taking into account the actual situation of the case.[34] However, a change of circumstances is generally regarded as a last resort for a party seeking performance exemption rather than a low-hanging fruit and catch-all solution. This is not only because of the complexity of the legal tests and the court's general reluctance to grant the equitable relief, but also because of the additional requirements published by the Supreme People's Court of China in 2009 (Fa [2009] No. 165) (i.e., in the wake of the global financial crisis in 2008) that the application of a change of circumstances in specific cases should be reviewed by the relevant higher people's court.

On April 16, 2020, the Supreme People's Court of China issued the Guidance Opinions on Certain Issues of the Adjudication of Civil Cases Related to the COVID-19 Epidemic (I) (Fa Fa [2020] No. 12) (Guidance I). Guidance I basically confirms that both the COVID-19 epidemic and the relevant administrative measures may constitute a force majeure event under PRC law. It requires that, except otherwise agreed by contract parties, in addition to the rules of force majeure and change of circumstances provided under

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[33] *Dalian Pengcheng Holiday Damu Co., Ltd. v. Dalian Zhengdian Watch Industry Co., Ltd.* ((2013) Liao Shen Er Min Kang Zi No. 14).

[34] Article 26 of the *Supreme People's Court of China Interpretation on Several Questions Concerning Application of the PRC Contract Law No. 2*. Please note that the Code has adopted this judicial interpretation with the relevant changes that has, to some extent, given relevant contracting parties more options to resolve contractual disputes and/or seek remedies available. The law on change of circumstances now reads, which is now Article 533 of the Code, "after the contract is concluded, if the basic conditions of the contract have undergone significant changes (*Note*: revising "significant change of the objective circumstances") that was unforeseeable upon contract formation but not commercial risk (*Note*: no longer excludes force majeure), the adversely affected party may renegotiate with other party (*Note*: adding renegotiation option) if the continued contract performance would be obviously unfair for such party (*Note*: deleting "it becomes impossible to realize the goal of the contract"); if such negotiation fails within a reasonable period, the parties may apply for the court or arbitral tribunal (*Note*: adding arbitral tribunal) to amend or terminate the contract at issue and the people's courts or arbitral tribunals should decide the case following the principle of equality and taking into account the actual situation of the case."

the existing law, the people's courts shall carefully examine the actual effect of a COVID-19-related impact on cases of different geographies, industries, and case scenarios, and accurately evaluate the causation and the degree of causality between the epidemic or epidemic prevention and control measures and the impossibility of performance.

On May 15, 2020, the Supreme People's Court further issued the Guidance Opinions on Certain Issues of the Adjudication of Civil Cases Related to the COVID-19 Epidemic (II) (Fa Fa [2020] No. 17) (Guidance II), which specifically provides guidance for people's courts at various levels to properly hear or try to address contract, financial, and bankruptcy cases involving COVID-19.

In general, (1) the force majeure rules shall apply if a contract is impossible to perform due to direct impact of an epidemic or epidemic prevention and control measures; (2) the force majeure rules shall not apply if a contract is merely difficult to perform due to COVID-19, although subject to the competent people's court's discretion, the rules of change of circumstance may apply; and (3) when determining whether a contract can continue to be performed, the factors of whether a party has received subsidies, tax relief, funding by third parties, or debt relief shall be taken into consideration by the people's courts. Guidance II recommends that the people's courts of a higher level should publish typical case examples as a detailed guidance to its lower level courts to ensure the uniformed adjudication standards for COVID-19-related civil cases.

Force Majeure Provisions in Agreements Governed by PRC Law

A typical force majeure provision in a contract governed by PRC law normally follows the statutory force majeure rules under PRC law and provides (1) the scope of the force majeure event; (2) the obligations of the party claiming for performance exemption under the force majeure rules (e.g., timely notification to its counterparty(ies), provision of proof of the force majeure circumstances, and implementation of appropriate measures to prevent further increase of losses); and (3) consequence of the occurrence of the force majeure event.

It is also worth mentioning again that a people's court would apply statutory force majeure provisions upon a party raising such claim, even though the contract is silent on force majeure or the provisions thereof are only vaguely written—unless there are express restrictions of the application of force majeure rules or "carve-outs" from the scope of the force majeure event, in which case the people's court will generally adhere to what the parties have agreed upon.

JAPAN

Update on Business Environment in Japan

Similar to other jurisdictions, Japanese businesses have suffered serious negative effects due to the COVID-19 pandemic and continue to struggle in their day-to-day operations. Under Japanese law, the Japanese national government may declare a state of emergency to contain new influenza outbreaks such as COVID-19 based on the Novel Influenza Prevention Measure Law, which was originally enacted in May 2012 and later amended to address the COVID-19 pandemic in March 2020.[35] Under this statute, the prime minister possesses the authority to proclaim a state of emergency if there is a new strain of influenza spreading throughout the country that threatens human life and the national economy.

On April 7, 2020, for the first time since the statute was enacted, Prime Minister Shinzo Abe proclaimed a much awaited state of emergency for the following major metropolitan areas in Japan: Tokyo, Kanagawa, Chiba, Saitama, Osaka, Hyogo, and Fukuoka. Subsequently on April 16, 2020, the prime minister expanded the state of emergency to the entire country of Japan.

[35] Act on Special Measures Concerning Countermeasures for Novel Influenza, etc. (Act No. 31 of 2012).

Although such declaration was lifted nationwide on May 25, 2020, due to being under the state of emergency for almost two months, many Japanese businesses have been negatively affected. Under the state of emergency, which was proclaimed at the national government level, many of the prefectural governors at the local level introduced emergency measures such as stay-at-home or shelter-in-place directives, restrictions on social gatherings and other public events, business shutdowns, financial assistance, stabilization of pricing on basic household products, extension of administrative procedures such as driver's license renewals, and other actions.

For example, the Tokyo Metropolitan Government implored Tokyo residents to stay at home unless necessary for food, medical care, and other essentials. It also directed certain businesses and academia to cease operations on a temporary basis. These business and institutions included universities, tutoring schools, amusement parks, sports and recreation centers, theaters (including movie theaters), gyms and health clubs, galleries, museums, night clubs, karaoke bars, pachinko parlors, concert halls, retail stores that sell items that are not essential to daily life, and others.

Although such local measures were neither mandatory nor legally binding, many citizens followed the directive, and as a result, many businesses suffered and continue to suffer from a negative impact caused by damage to the supply chain, decrease in demand, and the like.

General Overview of Force Majeure Law in Japan

Under these current circumstances in Japan, many parties to agreements are struggling to meet their contractual obligations. Under Japanese law, the starting point for legal analysis is reviewing the relevant agreement to see if there is a force majeure type of provision that excludes liability for nonperformance. If the agreement does not contain such a provision at all, or if the relevant provision is vague as to whether pandemics or epidemics constitute force majeure events, then the default rules under the Japanese Civil Code will govern.

It is worth noting that the Japanese Civil Code was recently amended, effective April 1, 2020. Accordingly, the previous version of the Civil Code in effect prior to April 1, 2020 will apply to agreements entered into before April 1, 2020, and the new Civil Code will apply to agreements entered into on and after April 1, 2020. Since most of the agreements at issue likely would be subject to the pre–April 1 Civil Code, we will first summarize the former rules under the prior Civil Code.

Article 415 of the prior Civil Code provides that "[i]f an obligor fails to perform consistent with the purpose of its obligation, the obligee shall be entitled to demand damages arising from such failure. The same shall apply in cases where it has become impossible to perform due to reasons attributable to the obligor."[36] As a corollary, if the contract obligation has become impossible for the obligor to perform due to reasons *not* attributable to the obligor, the obligee shall *not* be entitled to demand damages arising from such failure, i.e., the obligee shall be exempted from liability for damages caused by its nonperformance due to causes unrelated to the obligor.

Next, the question becomes what are "the reasons *not* attributable to the obligor." There is no guidance on this point under the prior Civil Code itself, but it is generally construed to be reasons caused by an external source, and not the obligor, and the failure to perform could not have been prevented even with due care.[37] The COVID-19 pandemic situation or government mandates or requests could be deemed to be an "external source" that could not have been prevented even with due care, but whether they are "reasons *not* attributable to the obligor" would need to be determined on a case-by-case basis. Therefore, it will be key to review various facts and circumstances surrounding the nonperformance,

[36] Japanese Civil Code, Article 415.

[37] Sakae Wagatsuma et al., *Wagatsuma, Ariizumi konmentaru minpo: sosoku, bukken, saiken,* 6th ed. p. 792 (Tokyo: Nihon Hyoronsha, 2019).

which might include whether the nonperformance occurred directly as a result of the global pandemic situation or whether the pandemic or the government directive was inevitable or unforeseeable.

Under the new Civil Code post–April 1, the default rule under Article 415 is basically the same, save for a few rules on related issues.[38] For example, under the previous Civil Code, the general understanding in Japan was that an obligee may cancel the contract upon a breach by the obligor if the breach was caused by reasons attributable to the obligor. By contrast, under the new Civil Code, the reasons attributable to the obligor are not necessary for the obligee to cancel the contract, and therefore, the other party may go ahead and terminate the contract if the obligor has not performed due to inevitable or unforeseeable events.[39]

Force Majeure Provisions in Contracts Governed by Japanese Law

A typical force majeure provision in an agreement governed by Japan law enumerates several specific events, such as earthquakes, floods, and other natural disasters, then includes a "catch-all" clause generally covering other events that are not attributable to the obligor. It is not common practice in Japan to call out a pandemic as a force majeure event, especially in those agreements that were entered into before the current COVID-19 pandemic.

If the contract language does not identify "pandemics" as force majeure events in particular, the question is whether the general catch-all provision would suffice to excuse performance due to obstacles presented by the COVID-19 pandemic, which would be resolved through the rules under the Japanese Civil Code described above. Likewise, if there is no force majeure provision in an agreement governed by Japanese law, the Japanese Civil Code would also apply. Under the Civil Code, the dispositive issue is whether the event can be attributed to the obligor.

PATH FORWARD IN THE 'NEW NORMAL'

The global nature of the COVID-19 pandemic has resulted in massive disruptions to the ordinary course of business and operations around the world. Parties to existing agreements should revisit their contractual obligations under those agreements to assess whether they can still continue to fulfill those obligations in light of the current crisis. If a party has concerns about its own ability to perform or the ability of the other party to perform, it should review the agreements carefully with their counsel.

If an agreement includes a force majeure provision, the party should analyze how a "Force Majeure Event" is defined in the agreement, and recognize that the interpretation and enforcement of the force majeure provision will depend on the governing law specified in the agreement. The parties should then consult counsel with in-depth knowledge and experience of force majeure law under the governing law that applies to the agreement.

Most force majeure provisions permit a relatively short period of time during which performance can be excused (e.g., 60 days). While this hiatus may provide some reprieve for the contracting parties, this does not mean that the parties may completely disregard their contractual obligations. The hiatus may offer some much needed time for the parties to confer with their respective counsels, evaluate their options, propose alternatives, and/or prepare to initiate legal action.

Whatever the course of action, because the way force majeure provisions are interpreted and applied varies by jurisdiction and country, parties will want to not only ensure that there is a clear and well-drafted force majeure provision in every international business agreement but also negotiate in advance both the governing law and an international dispute resolution mechanism. Especially in a cross-border

[38] Japanese Civil Code, Articles 541 to 543, effective April 1, 2020.

[39] *Id.*

context, any disagreement between the parties can be resolved effectively through international mediation or arbitration such as those conducted under the mediation or arbitration rules of the International Chamber of Commerce (ICC). The benefits of agreeing on an international dispute resolution procedure are vast, but one key benefit is that the parties can agree to resolve the dispute through international mediation or arbitration to be conducted in the English language or any other agreed-upon common language. Without such international dispute resolution language in agreements for cross-border transactions, a party may be hauled into court in an unfamiliar jurisdiction or stymied by language and other barriers.

Force Majeure Task Force

Recognizing that state laws on force majeure provisions may differ, Morgan Lewis has a Force Majeure Task Force with members who practice in different states in the United States and who have deep knowledge and experience in this area, especially during the ongoing COVID-19 pandemic.

Coronavirus COVID-19 Task Force

For our clients, we have formed a multidisciplinary Coronavirus COVID-19 Task Force to help guide you through the broad scope of legal issues brought on by this public health challenge. Find resources on how to cope with the post-pandemic reality on our NOW. NORMAL. NEXT. page and our COVID-19 page to help keep you on top of developments as they unfold. If you would like to receive a digest of all new updates to the page, please subscribe now to receive our COVID-19 alerts, and download our COVID-19 Legal Issue Compendium.

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