Covid-19 and contracts in China and Europe

Jacques Henri Herbots¹

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Abstract

The purpose of this succinct contribution is to present to the readers the Chinese law of contract on “force majeure” and “hardship,” in a comparative perspective from a European point of view. The concept of foreseeability of the event rendering the performance of the contract impossible or unbearably difficult is used as an eye-catcher. The two concepts “force majeure” and “hardship” are close to each other, but must be sharply distinguished. One has to also distinguish the foreseeability of the event (of “force majeure” or “hardship”), which causes the hindrance of the performance of the contract, from the foreseeability of the damage suffered because of the non-performance.

Keywords Covid-19 · Force majeure · Contract

The Covid-19 pandemic, lockdowns and other preventive measures can be put forward by a party in a legal claim based on the non-performance of a contract. For each dispute, however, it is necessary to prove that the outbreak, the measures and its consequences for the contractual situation were not foreseeable when the contract was concluded. That is so in Chinese, as well as in European law.¹ Some may believe that the empress dowager of the Qing dynasty, Cixi, could have foreseen the outbreak in her famous fortune-telling crystal ball, now on display in the museum of Philadelphia. The point of view of the Supreme People’s Court is more prosaic: could the catastrophe have been foreseen, or not, by a normal citizen,—the man on the Clapham omnibus, or as they say in Hong Kong, the man on the “Shaun kei wan tram”, in other words someone who is not an expert, for instance a virologist. That is of course a question of fact which has to be proven at court.²

¹ For the principles of a European law of contract, one could consult: Beale et al. (2010), Hartkamp (2011), Lando and Beale (2000) and Smits (2014).

² A guiding opinion of 2009, cited below, uses the phrase: the People’s Courts shall assess whether the risk was unforeseeable according to *the general social opinion* and whether the extent of the risk was far beyond the normal reasonable expectation of *an ordinary person*.

✉ Jacques Henri Herbots
monty.silley@uni-hamburg.de; jherbots2012@yahoo.com

¹ KU Leuven, Leuven, Belgium

From a certain date on, the outbreak could of course be known and the consequences for each actual dispute foreseen. To put a date on the public knowledge of the outbreak is not easy. On 9 January 2020 Xu Jianguo, chief expert of the Chinese crisis team, told the State's media that in his opinion a new corona virus was spreading. On 23 January, Wuhan was locked down. On 30 January the director-general of the WHO, Ghebreyesus, praised the PRC for its response to the outbreak, declaring only on 11 March 2020 the outbreak of a pandemic.

We will point out in this paper three Articles in the Chinese Contract Act of 15 March 1999³ and in the new Civil Code which was issued on 28 May 2020 at the third session of the thirteenth NPC. Nothing much has changed in comparison with the previous Contract Act, other than the incorporation of the Interpretations of the Supreme People's Court. The Code came into force on 1 January 2021. These three Articles which may be invoked in the Covid-19 related claims contain the requirement of unforeseeability, and (1) the damage caused by the non-performance of the contract, as well as of (2) an event characterized as force majeure excusing the non-performance, or (3) causing hardship to the performer.

1 Damage caused by the non-performance of the contract

In the case of non-performance of a contract one of the possible remedies of the claimant is to sue for damages. Another remedy could be the termination of the contract. The Guiding Opinion of the Supreme People's Court on Covid-19 related civil disputes of 20 April, 2020 reminds the courts that a party's request to terminate a contract is only possible if the *purpose of the contract* cannot be realized due to the epidemic situation or epidemic prevention and control measures.⁴

What about damages? Damages must compensate completely the loss caused by the breach of contract. An issue of causality therefore arises here. All the losses, which would not have incurred "but for" the breach must be compensated. But they may not exceed a certain limit. That limit is indicated by the loss which the party in breach, at the time of the conclusion of the contract, could have *foreseen* or *ought to have foreseen* as a *possible* (not probable) consequence of the breach, in the light of the facts of which that party knew. The court cannot condemn the party in breach to higher damages than those due for the foreseeable consequences of the breach.

An example given by Professor Wang Liming of Renmin University resembles the famous example given in the eighteenth century by Pothier, a French judge and professor in Orleans. When a cow, having a hidden contagious disease, dies shortly after the delivery by the seller to the buyer, that damage suffered by the buyer can

³ See Herbots (2018, p. 54-58 and 64-68).

⁴ *Guiding Opinion of the Supreme People's Court on COVID-19 related civil disputes*, translated by Mimi Zou (Renmin university), 20 April 2020, Supreme People's Court Monitor. The opinion doesn't only treat the problem of non-performance of contracts. In the basket one also finds problems of civil procedure, labour law, labour contract law, punitive damages in consumer rights protection, food safety and drug administration.

be *directly* attributed to the breach of the seller who did not disclose the illness. It is a question of causality. The damage caused by the sick cow contaminating the other animals in the farm is an *indirectly* caused damage which is foreseeable. But further consequential damages are, it is suggested, not foreseeable: the missed harvest (due to not plowing of the land because of the death of the oxen owing to the illness), the bankruptcy of the farmer and later his suicide.⁵

In the Common Law, a classic precedent from 1854, which is still cited in England and Wales as well as in Hong Kong, is *Hadley v. Baxendale*, which was inspired by Pothier. The facts are well known. The mill of the plaintiff at Gloucester was brought to a standstill by a broken crank shaft, and it became necessary to send the shaft to the makers at Greenwich, for a new one. The defendant, a carrier, promised to deliver it at Greenwich on the following day. Owing to his neglect, it was unduly delayed in transit, with the result that the mill remained idle for longer than it would have done, had there been no breach of contract. The plaintiff, therefore, claimed to recover damages for the loss of profit caused by the delay. The failure of the carrier to perform the contract punctually was the direct cause of the stoppage of the mill for an unnecessarily long time, while the miller had no spare shaft in reserve. The special circumstances, however, were not fully disclosed to the carrier. The only information given to him was that the thing to be carried was the broken shaft of a mill and that the other contractual party was the miller. Lost profits must be compensated in principle, but in this case the damage—the consequential loss—was unforeseeable.⁶

Lost profit. The “*Hetong Fa*” of 1999 provides for damages for lost profit—a novelty after the great changes operated by Deng Xiaoping, i.e. the benefits which could have been obtained if the breached contract had been performed. A guiding opinion of the Chinese Supreme People’s Court from 2009 sheds some light on the calculation of the lost profits. The opinion states that calculating the expectation damages related to the loss of potential profits, courts should deduct from the total the amount of the loss that was unforeseeable by the breaching party.

Article 113 of the Act on Contracts of 15 March 1999, and the new Article 584 of the Civil Code of the PRC state: “Where a party fails to perform its contractual obligations or where its performance fails to conform to the agreement, and this causes damage to the other party, the amount of the compensation of it should equal the losses caused by the breach of contract, including any profit which would have resulted from the performance of the contract, provided that it does not exceed the amount for the losses which could possibly be caused by the breach of contract and which were foreseen or should have been foreseen when the party in breach concluded the contract.” (Unofficial translation)

Let us take a simple example. A factory of medical facemasks entered, in December 2019, into a contract of sale with a supplier of the material needed for their production. Because of a breach of contract of the latter in February 2020 *not* related

⁵ See footnote 10.

⁶ One could consult : Beale (2004); Beatson et al. (2010), Calamari and Perillo (2003), Chen-Wishart (2015), Furmston (2017), Poole (2012) and Treitel (2007).

to the epidemic, but to an error in the stock management, the factory loses contracts with possible European buyers which it could have entered into and which would have been substantial in light of the increased worldwide prices of these coveted masks. Although the factory of masks can in principle obtain compensation for the lost benefit, this loss cannot be calculated on the basis of the *new* much higher prices (which were not foreseeable in December 2019).

2 An event of force majeure

Another topic in which our crystal ball appears, is called *force majeure* (translated in pinyin as ‘Bùkěkàng lì’), a French term of art, from the Latin *vis maior*, with no equivalent term in English law.⁷

In Articles 117 and 118 of the Contract Act *force majeure* leads to exemption of liability.⁸ Article 590 of the Civil Code of the PRC states in a similar way (in one article instead of two as it did before) that “where a party is unable to perform a contract due to *force majeure*, the party shall be *exempt from liability* in part or in whole based on the impact of the *force majeure*, except as otherwise provided by law. In such a case, the party shall promptly notify the other party to mitigate the loss possibly caused to the other party and provide proof within a reasonable time limit. If force majeure occurs after a party delayed performance, the party shall not be exempt from liability for breach.”

Force majeure means an event which is unforeseeable, but is also unavoidable, and which cannot be overcome (Article 180 of the *General Provisions of the Civil Law* of 15 March 2017; Article 117 of the Contract Act of 15 March 1999). The definition is not repeated in Article 590 of the Civil Code. The party invoking it must demonstrate an impediment, a hindrance, *beyond its control*. Difficulties due to his personal financial problems (insufficient liquidities) for instance are not considered as such. Typical categories are: natural disasters (earthquake, flood and volcanic eruption), collective social events (war, strike⁹, restraint of labour) and government action (quarantine, seizure under legal process). The maritime law of the PRC of 1992 lists some typical events which might be considered to be *force majeure* events in maritime transport, like war or armed conflicts, fire, or quarantine restrictions (art. 51).

At Common Law *force majeure* is not a term in use, English maritime law speaking instead of an “act of God”, but a strike or quarantine can hardly be considered an act of God. The extent to which the parties deal with unforeseen events has to

⁷ See Tao Jingzhou, “Breaking contracts over corona virus is harder than it seems”, Financial Times, Wednesday 26 February 2020, 9.

⁸ Force majeure is also mentioned in Article 194 of the General Provisions on Civil Law, where it leads to a suspension of the limitation period, when a demand cannot be made due to *force majeure* in the last six months of the limitation period.

⁹ Although most of the strikes did take place at foreign-owned facilities, a few Chinese companies also experienced labour unrest. The right to strike was recognized in the short-lived Constitution of 1978, but disappeared from the Constitution of 1982.

be defined in the contract. Without a specific clause, there will not necessarily be a relief for *force majeure* events in the Common Law.

A People's Court accepted the principle that a fire which destroyed all the machines and stocks of a textile factory could be considered as being *force majeure*, but the breaching party should have notified it without delay to the other party.

The non-performing party must demonstrate that it could not reasonably be expected to have taken the event into account at the time of the contract. In a case dealt with by the court of Tianjin, it was held that the number 9711 storm should be treated as a *force majeure* event, although it had been forecast by the National Marine Environment Forecasting Centre. The weather report had been made after the contract had been signed. Although an expert could foresee the storm in advance, it does not mean that the contractual parties could expect the possibility of the storm during the period wherein the contract was concluded. In another case involving a flood, the defendant had foreseen the possibility of the flood at the conclusion of the contract. There was, however, sufficient evidence showing that the actual level of water turned out to be much higher than what had been expected.

It is without doubt that the Covid-19 epidemic is an event of *force majeure* in the sense that it was (up until a certain date after the conclusion of the contract) unforeseeable and unavoidable, unlike other epidemics which one can find for instance in the French case law (dengue fever, flu H1N1, SARS, Chicungunya, etc.) and which were foreseeable and could be overcome. The Guiding Opinion of the Chinese Supreme People's Court on Covid-19 related civil disputes of 20 April 2020 states that the party claiming partial or total exemption from liability due to *force majeure* shall bear the burden of proof of the causal link between epidemic and non-performance. In order to grasp the causal relationship between the epidemic situation or epidemic prevention and control measures and the party's failure to perform, the People's Court should consider the impact on *different* regions, *different* industries and *different* cases. The China Council for the Promotion of International Trade, a quasi-governmental organization, issued in February 2020 more than 1600 *force majeure* certificates covering contracts worth more than \$15bn that shield companies in 30 sectors from legal claims. But, as the CCPIT warns, claims of *force majeure* are not a trump card for getting out of an unwanted deal.

The event must render the performance *impossible*. If the performance is still practicable, although more expensive, *force majeure* cannot be invoked as an excuse. If for instance a producer is confronted with a breach of contract of a supplier of an essential component, whose factory is closed down by the authorities because of the epidemic, but can still find another supplier, be it at much higher costs, his performance is still possible.

If *the purpose of the contract* cannot be realized (“*bu neng shixian hetong mudi*”) due to the epidemic situation or epidemic prevention and control measures and the parties request the termination of the contract, the People's Court shall support such a request. But only in that case. Article 94 of the Contracts Act and Article 563 of the Civil Code state that “the parties to a contract may terminate the contract where (1) it is rendered impossible to achieve the purpose of the contract due to an event of *force majeure*; (...) (4) where the other party delays performance of its obligations, or breaches the contract in some other manner, rendering impossible the

purpose of the contract.” A fundamental breach (“*geng ben wei yue*”) is recognized as the essential condition for the termination of a contract. Unforeseeability is not expressly mentioned in the above point (4) of Article 94 Contract Act and of the similar Article of the Civil Code.

The requirement of *impossibility* marks the borderline with another doctrine, namely the doctrine of ‘hardship’. The two doctrines have in common the occurrence of an unforeseeable event but in the hypothesis of “hardship” this event leads to an extremely difficult performance, harsh, but still practicable, whatever it may cost. In the Guiding Opinion on Covid-19 related disputes the difference is clearly made: if the epidemic situation or epidemic prevention and control measures only cause difficulties in performing the contract, the parties may renegotiate. That i all. If the parties request the termination of the contract based on the difficulty of performance, the People’s Court shall not support it.

3 An unforeseeable event causing hardship to the performer

We enter now the third room wherein again we find the crystal ball: it is the hardship room, situated quite closely to the *force majeure* room.

What is hardship? The Civil Code of the PRC does not provide a definition. Neither did the previous Act on Contracts of 1999, although as far back as 1994 an early bird, UNIDROIT, gave an answer in the *Principles of International Commercial Contracts*: an event which fundamentally alters the equilibrium of the contract, either because the cost has increased or because the value received by the other party has diminished. The event must present the following characteristics: (a) occur *after* the conclusion of the contract; (b) could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion; (c) be *beyond control* of the disadvantaged party; (d) the risk of it was *not assumed* by the disadvantaged party. This was very new at that moment.

In many foreign laws “hardship” is not accepted as an excuse for not performance. Before the Guiding Opinion of 2009 this was also the case in the PRC. Let us look first to the Romanist law systems, and more specifically to the famous French leading case of the Canal of Craponne of 1856. To understand this case we have to go back three centuries. In 1567 Sir Adam de Craponne constructed a canal in a commune in the south of France. The inhabitants contributed towards the costs. Sir Adam undertook to maintain the canal for a payment of 3 sols for every 2 hectares irrigated by the farmers of the commune. As time went by, this sum became derisory and inappropriate for the cost of maintaining the canal. So, in the 19th century, his heirs sued for an increase, which was granted by the court in first instance. But the inhabitants sought review and won on appeal to the highest Court. The *Cour de Cassation* judged that the Court of Appeal of Aix-en-Provence manifestly violated a fundamental Article of the Civil Code by modifying the agreement of the parties, however equitable it may have seemed to them to do so. It is no part of the function of a court to modify a contract, the judges said. The judgment of the Court of Appeal was quashed, and since then the French Courts stayed with this doctrine, called “*la théorie de l’imprévision*”. Also in other countries of the Romanist family

the doctrine of hardship was rejected, except in administrative contracts.¹⁰ Recently, however, the wind has changed in the Romanist family, e.g. in Spain, following the lead of UNIDROIT. In France an ordinance of 10 February 2016 implements a reform of the contract law, implying the adoption of the doctrine of hardship. Belgian law is on the brink of following the lead.¹¹

In Germany, since the terrible economic crisis in the aftermath of the First World War and later the bank crash of 1929, relief could be granted, using the notion of good faith (“*Treu und Glauben*”) and of a so-called doctrine of the “*Wegfall der Geschäftsgrundlage*” (disappearance of the basis of the transaction). This latter doctrine covers the effect of changed circumstances on the contract. At present it is applied rather restrictively.¹²

On the contrary, in Common Law systems (like that of Hong Kong) relief for hardship is never granted in the absence of an express contractual provision. The doctrine of *frustration* is something different. In English law this doctrine excuses performance when the circumstances have changed so much that the performance required by the contract is *radically different* from that which was initially undertaken by the parties. An economic hardship will *not* render a contract frustrated.¹³

In the PRC, at the end of the legislative procedure leading to the vote of the Contract Act of 15 March 1999 the doctrine of “the unforeseen change of the situation” (“*Qing Shi Bian Geng*”) was rejected by the general assembly of the NPC. As a result, the Contract Act did not make any reference to the doctrine of hardship. However, a “*Pifu*”, nr. 27 of 1992 of the Supreme People’s Court, a reply to a question of a lower court, paved the way for later developments on grounds of the principle of good faith found in the General Principles of Civil Law of 1986, like the German courts had done.

The case concerned an agreement for the supply of external tanks for gas meters, signed when the price of an essential component, aluminum ingots, set by the State, ranged between CNY 4.400 and 4.600 per ton. Following the market liberalization, the price of aluminum quadrupled, amounting to CNY 16.000 per ton. This meant that the price of the gas meter’s external tanks increased from 23.085 to 41.000 CNY per piece. This is evidently a case of hardship. The Supreme People’s Court ruled that requiring the supplier to sell the gas meter’s tanks at the initially agreed price would have lead to an unfair result in violation of the principle of good faith.

Ten years after the refusal of the doctrine of hardship by the NPC, in 2009 after the international bank crisis following the collapse of the Lehman Brothers Bank, one of the first achievements of the Chinese Supreme People’s Court’s

¹⁰ One could consult: Bénabent, A., “Droit des obligations”, L.G.D.J., 2017; Fabre-Magnan (2016); Fleur, J. and Aubert, J.-L., “Les obligations”, 2006; Larroumet, C., “Droit civil 3, Les obligations”, Paris, Economica, 2007; Malaurie, P. and Aynes, C., “Les obligations” 11th ed., Paris, Cuias, 2001; Malinvaud, P. and Fenouillet, D., “Droit des obligations”, Lexis-Nexis, 2012.

¹¹ Chénéde, Fr., “Le nouveau droit des obligations et des contrats 2019/2020”, Paris, Dalloz.

¹² Markesinis et al. (2006).

¹³ See footnote 6.

Second Interpretation of the Contract Act of 13 May 2009 and of the Guiding Opinion of 7 July 2009 was the formal recognition of the doctrine of the change of circumstances.¹⁴

The Guiding Opinion makes use of the “*heli*” (reasonability) standard in an instruction wherein the Supreme People’s Court states that in dealing with cases affected by a significant change of circumstances courts shall “reasonably adjust the interests of the parties”. Specifying the meaning of “reasonable adjustment”, the SPC says that the application of the principle of the change of circumstances does not mean releasing the debtor’s obligations, but “fairly and reasonably” balancing and adjusting the respective interests of the parties, guiding them in renegotiations of the contract, and further mediating the contractual dispute in the event of *the failure of the renegotiation*. In a circular, a strict supervision has been provided over cases of application of such a complex judicial evaluation, in which fairness (“*gong ping*”) and reasonableness (“*heli*”) are the leading criteria to be followed. When they want to apply this doctrine the courts must report for review to the higher court, and eventually to the SPC.

The Courts will not depart from the principle that contracts must be honored, and risks lie where the parties have agreed, unless such a departure is necessary to avoid *intolerable* results irreconcilable with law and justice. The Italian Civil Code uses the expressive image “*eccessiva onerosità*” (*extortionate load*). Where continued performance is *manifestly unfair* to one party, and if that party requests to modify the performance period, method of performance, price amount, etc., the People’s Court shall decide whether to support that request in the light of the actual circumstances of the case. For instance, if a party has received government subsidies, tax relief or other funding and debt relief due to the epidemic situation, the People’s Court will take this factor into account.

The new Article 533 of the Civil Code of the PRC, incorporating the Interpretation of 2009 of the Supreme People’s Court, is pushing a progressive agenda: “Where the basic conditions of a contract undergo a material change which was unforeseeable at the time of the conclusion of the contract, and which is not a commercial risk to be assumed after the formation of the contract, rendering the continuation of the performance of the contract grossly unfair for either party, the disadvantaged party may renegotiate with the other party; and if the negotiation fails within a reasonable time limit, the party may request the People’s Court or an arbitration institution to modify or terminate the contract. The People’s Court or arbitration institution shall change or terminate the contract based on the actual circumstances of the case, in accordance with the principle of fairness.” (unofficial translation)

Up until now the Court has applied this doctrine only to domestic contracts. The Convention on the International Sale of Goods, applied in mainland China as Contracting State, contains an Article 79 on *force majeure*, but nothing at all on hardship. A recent and much publicized (and criticized) decision of the Belgian *Cour de Cassation* (19 June 2009) ruled that under Article 79 CISG a party could be exempted from liability on grounds of unforeseen circumstances that would

¹⁴ See footnote 3.

unreasonably aggravate the burden of performing the contract. One is waiting for a decision of the Supreme People's Court.¹⁵

4 Conclusion

Different legal concepts exist in all legal systems dealing with the problem of changed circumstances and excusing a party from performance. Some systems accept a narrow range of excuses; others are more generous. The law of mainland China belongs to the latter.

As long as the outbreak of the virus, considered as an event of *force majeure*, did not appear in the crystal ball of the parties, (1) the loss caused by it, must *not* be compensated; (2) the breaching party may be *exempted* from liability in case of *impossibility* to perform, on condition that all measures were taken to overcome it; (3) the parties may *renegotiate* the contract in case of *hardship*, and the People's Court can modify the contract or particular provisions may be treated as void. Only in extreme cases is the whole contract rescinded.

Needless to say, on the contrary, if the outbreak of the Covid-19 epidemic did appear in the crystal ball of the parties to the contract, the risks are presumed to have been taken into account. Consequently, the loss should then lie where it falls.

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¹⁵ Lookofsky, J., "The 1980 United Nations Convention on Contracts for the International Sale of Goods", International Encyclopaedia of Laws, Contracts, Supplement 122, Wolters Kluwer, 2020, nr. 308.