

Kira Study

FEBRUARY 2020



Force Majeure Provisions
in Chinese Contracts



Growing Concern: What We Learned From Looking At What Chinese Contracts Say About Force Majeure

The current coronavirus outbreak has seen an increasing number of Chinese businesses seeking exemptions for non-performance or non-compliance under their contracts. The economic effects are already rippling worldwide as supply chains and commodities markets are being thrown into turmoil. With the rapid spread of the coronavirus, the extension of the Lunar New Year holiday by the Chinese government, and transportation disruptions leaving hundreds of millions of workers unable to return to work (among other things) many Chinese businesses are struggling to fulfill their contractual obligations. As of February 11, nearly as many as 100 Chinese enterprises have received force majeure certificates from the China Council for the Promotion of International Trade. The certificates acknowledge the outbreak as a force majeure event, authorizing the businesses to declare that a force majeure has occurred in relation to their contracts.

Over the last two weeks, a number of major Chinese companies have claimed force majeure to excuse delays in their performance under their contracts. These include: China National Offshore Oil Corporation (CNOOC), the country's largest importer of liquefied natural gas; Guangxi Nanguo, a copper smelter with an annual production capacity of 300,000 tonnes; and Jiangsu New Times Shipbuilding, a shipbuilder with an annual production capacity of 5 million deadweight tonnes (DWT). International companies with operations in China have also taken measures like closing factories and stores.

Companies with China in their supply chains should be hard at work considering whether they are in for disruption. Force majeure clauses constitute an important part of this story. Today, there is a lot of conjecture. We thought it worthwhile to leverage our contract review AI to generate actual data on what real Chinese contracts say about force majeure.



Force Majeure in Contracts: Does Coronavirus Qualify?

Force majeure provisions in contracts establish the circumstances under which a party's obligations under the contract may be suspended, or otherwise altered, due to events deemed to be out of the affected party's control. Examples include natural disasters, acts of terrorism or war, acts of God, labor disruptions, or even pandemics. As we have [previously noted](#), force majeure provisions are important because the occurrence of a force majeure event can result in any number of effects such as a party's exemption from performing its contractual obligations (important to the non-affected party), potential notification requirements (important to the affected party), or even the possibility of terminating the contract altogether (important to all parties).

Unsurprisingly, whether the coronavirus outbreak counts as a force majeure event under a given contract depends on the wording of the force majeure provision in the contract. Because of this, we took a closer look at a sample set of contracts involving Chinese entities to better understand what they include with respect to force majeure.

Kira Insights: Force Majeure Provisions in Chinese Contracts

We used Kira to review 176 commercial contracts involving Chinese entities to determine (1) the overall prevalence of force majeure provisions (with a separate analysis for loan and credit-related agreements); (2) the prevalence of force majeure provisions that expressly include public health-related events in the definition of force majeure; (3) the prevalence of force majeure provisions that include either broader "catch-all" language in the definition of force majeure or public health-related events in the definition of force majeure; and (4) the prevalence of force majeure provisions including acts of government in the definition of force majeure.

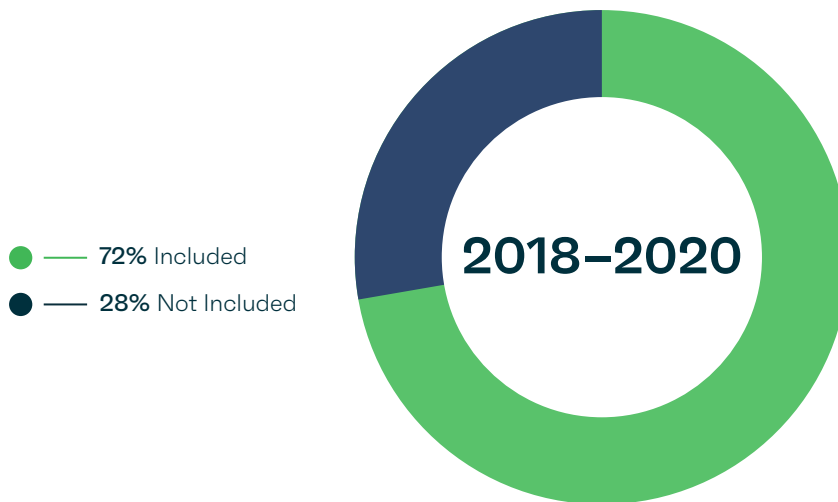
Our sample set comprised 130 service agreements, supply agreements, intellectual property agreements, real estate agreements, and joint venture agreements involving at least one Chinese entity that were filed on EDGAR between February 2018 and February 2020. We also reviewed 46 loan and credit-related agreements, also filed on EDGAR between February 2018 and February 2020. We imported the agreements into Kira, and, using Kira's already-existing "Force Majeure" provision model, were able to automatically identify which agreements included force majeure provisions.



Once Kira determined which provisions included force majeure provisions, we reviewed the results to further identify which force majeure provisions included public health-related events, which force majeure provisions included catch-all language, and which force majeure provisions included acts of government. One neat thing about this study is that it took us under 10 hours of work to identify the variations we were seeking in all 176 contracts, and to perform a more detailed analysis that ultimately yielded the data we compiled for this report. As a baseline, studies done without the use of AI can take weeks or months to complete.

Prevalence of Force Majeure Provisions

Our analysis in Kira indicated that many of the contracts provided for procedures to be followed in the event of a force majeure occurrence. Out of the 130 contracts, 72% included force majeure provisions.¹



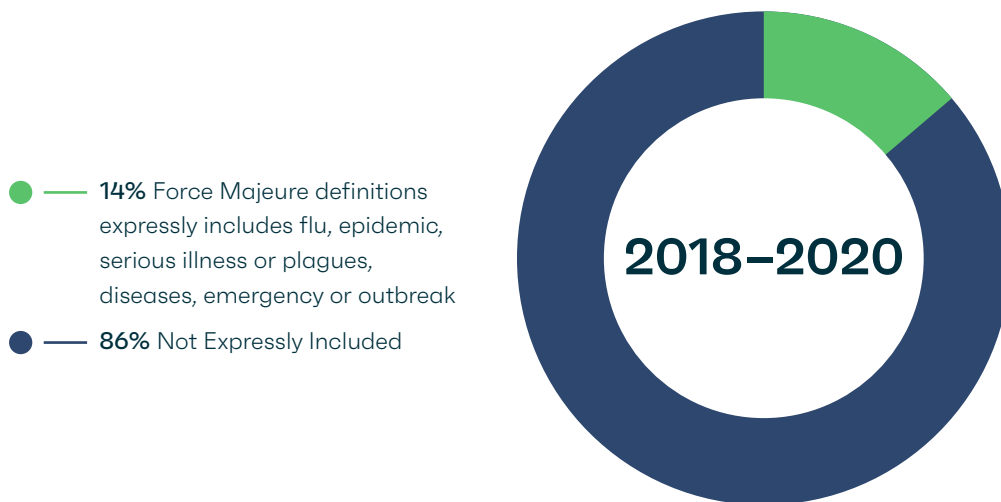
Source Data: 130 commercial contracts involving at least one Chinese entity, filed on EDGAR between February 2018 and February 2020, analyzed by Kira.

¹ Even if a force majeure provision is not included, or the coronavirus does not otherwise qualify as a force majeure event, the Chinese law doctrine of “changed circumstance” may apply to modify or invalidate the contract.



Public Health-Related Events in Force Majeure Provisions

Force majeure provisions do not often specify public health-related events as force majeure events. As we expected, out of the 94 contracts with force majeure provisions, 13 of them included force majeure provisions explicitly stating that public health events such as flu, epidemic, serious illness or plagues, disease, emergency or outbreak would constitute a force majeure situation.²



Source Data: 94 commercial contracts involving at least one Chinese entity, filed on EDGAR between February 2018 and February 2020 with force majeure provisions, analyzed by Kira.

This data suggests a gap in contract drafting, at least from the perspective of the entities affected by the coronavirus outbreak seeking to invoke their force majeure clauses. In drafting contracts going forward, contracting parties may wish to plan for contingencies similar to this in order to avoid ambiguity when time is of the essence.

² Examples include the following:

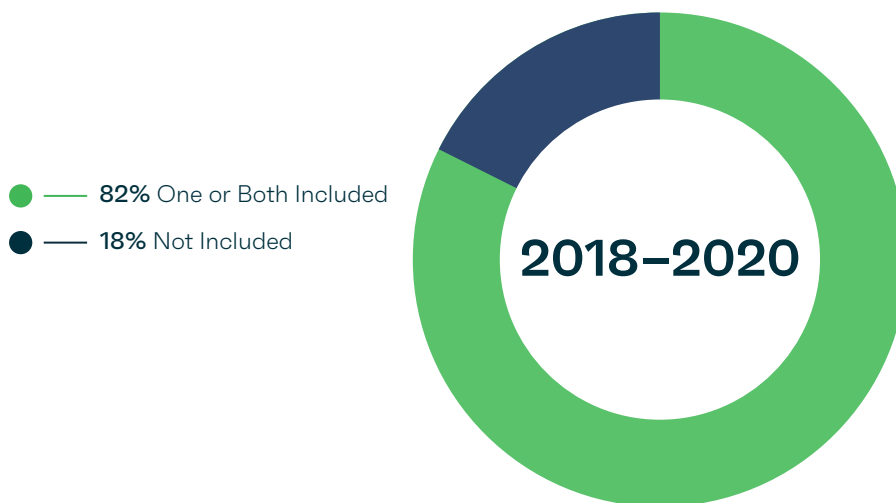
Force majeure events include only natural disasters, storms, tornadoes and other weather conditions, strikes, closures/shutdowns or other industry issues, wars, riots, conspiracy, enemy acts, terrorist acts or criminal organizations acts, blockades, *serious illnesses or plagues* (emphasis added)

In the case of any force majeure events (“Force Majeure”) such as earthquake, typhoon, flood, fire, *flu* (emphasis added)



“Catch-All” Language in Force Majeure Provisions

A larger portion of the contracts included “catch-all” language in the force majeure provisions. Catch-all language states that “any other events that cannot be predicted and are unpreventable and unavoidable by the affected [p]arty”, constitute force majeure. Of the 94 contracts with force majeure provisions, 82% either incorporated catch-all language or specifically enumerated public health-related events as described above in the definition of force majeure.³



Source Data: 94 commercial contracts involving at least one Chinese entity, filed on EDGAR between February 2018 and February 2020 with force majeure provisions, analyzed by Kira.

Because of the flexibility catch-all language provides, businesses affected by the coronavirus that are considering whether to invoke the force majeure clause in their contracts may have a valid argument that the outbreak qualifies as an unpreventable and unpredictable force majeure event. On the other hand, if dealing with an entity that has been affected by the outbreak, practitioners should review any relevant contracts for force majeure provisions in order to anticipate whether that party may make a claim that a force majeure event has occurred and that its non-performance under the contract may be excused, and to begin taking steps to mitigate any related losses.

³ Examples include the following:

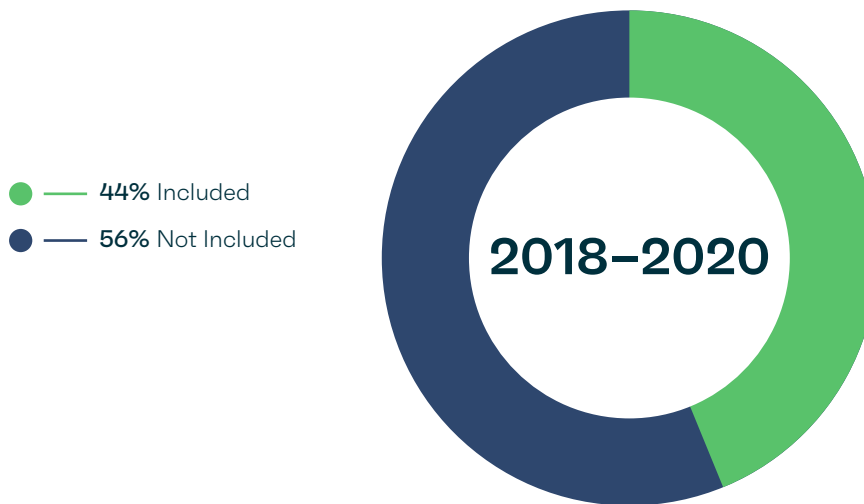
In the event of earthquake, typhoon, flood, fire, war, computer virus, loophole in the design of tooling software, internet system encountering hacker’s invasion, change of policies or laws, and *other unforeseeable or unpreventable or unavoidable event of force majeure*, which directly prevents a Party from performing this Agreement or performing the same on the agreed condition (emphasis added)

“Force Majeure” will mean war, earthquake and *other events which are unforeseen, inevitable and beyond the control of the Party* (emphasis added)



Acts of Government

A significant portion of the force majeure provisions also stated that acts of government would qualify as force majeure events that would excuse an affected party's non-performance. Of the 94 contracts including force majeure provisions, 44% included acts of government in the definition of force majeure.⁴



Source Data: 94 commercial contracts involving at least one Chinese entity, filed on EDGAR between February 2018 and February 2020 with force majeure provisions, analyzed by Kira.

The acts of government language in force majeure provisions provides affected parties with yet another approach in the attempt to claim a force majeure event has occurred as a result of the coronavirus. Affected parties could ostensibly cite the governmental extension of the Lunar New Year holiday, the mandated closing of businesses, and travel restrictions in Hubei Province and other provinces as acts of government beyond their control in order to avoid incurring liability for delays in performance or failure to perform. As with the catch-all provision, if dealing with an entity that has been affected by the outbreak, practitioners should review the relevant force majeure provisions in potentially affected contracts to anticipate if a claim might be made, and/or to begin mitigating any related losses.

⁴ Examples include the following:

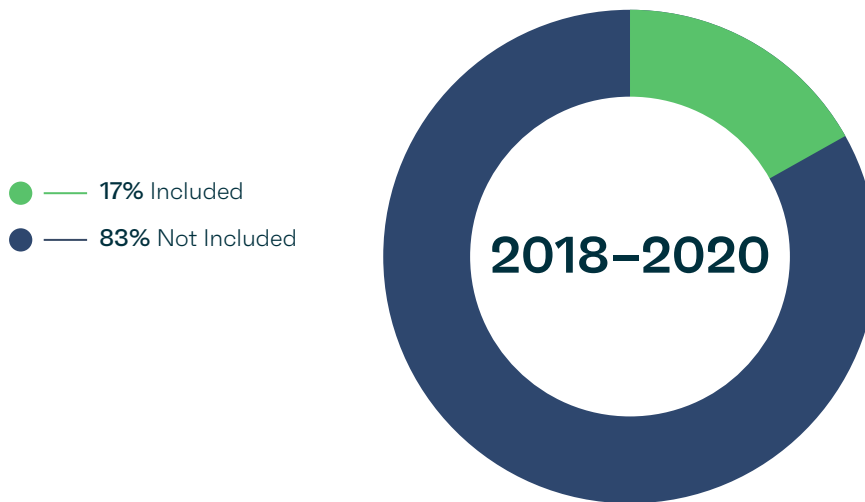
[T]he force majeure referred in this Article shall include (but [is] not limited to): (1) It is influenced by *the policy or any regulations of the competent government department or government authority*, and the affected party shows the certificate issued by the relevant competent department or authority (emphasis added)

Force Majeure means any of the events beyond the reasonable control of one party, and even under the attention of the affected party, any of the events is still unavoidable, including but not limited to, *acts of government* (emphasis added)



Loan and Credit-Related Agreements

We also reviewed loan and credit-related agreements involving Chinese entities separately after an initial review of the results Kira provided indicated a significantly lower prevalence of force majeure provisions in those agreements. Of the 46 loan and credit-related agreements we reviewed, only eight included force majeure provisions.



Source Data: 94 commercial contracts involving at least one Chinese entity, filed on EDGAR between February 2018 and February 2020 with force majeure provisions, analyzed by Kira.

Because of the high volume of results our document search returned, it was a challenge to construct exact search terms for each kind of agreement. As a result, a significant number of the loan agreements appear to involve companies loaning funds to entities owning equity in them—essentially, related party transactions—which may explain the lower prevalence of force majeure provisions in this category.



Conclusion

As illustrated by the varied wording in the force majeure provisions we reviewed, entities affected by the coronavirus outbreak appear to have multiple avenues to declare that a force majeure event has occurred, allowing for performance delays or non-performance under their contracts without incurring liability. Businesses dealing with affected entities should also review relevant contracts to adjust their expectations with respect to contract performance and/or develop a plan to mitigate any related losses.

With the severity and prevalence of the coronavirus escalating quickly, and more businesses and industries affected each day—from [auto parts supply](#) to [meat imports](#)—the volume of contracts that may warrant review for force majeure provisions is growing as well. As with other situations in which time is short, lawyers are overextended, and answers are needed quickly and with a high degree of accuracy, Kira can help quickly identify force majeure provisions and determine the impact of a potential force majeure event. If you would like to learn more about how machine learning software such as Kira can help you instantaneously find force majeure provisions in contracts (in addition to other essential contract provisions), go [here](#).

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