

How the coronavirus outbreak might affect your business contracts



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Contracts are the lifeblood of businesses



Contracts are a key part of doing business, as they set out expectations and govern relationships between business partners.

The rapid outbreak of the novel coronavirus is becoming a significant business challenge. Some businesses are finding it difficult to perform their contractual obligations despite their best intentions. Industries that may be particularly affected include events, tourism, manufacturing, logistics, retail and F&B. Your business may now be facing similar difficult questions in terms of how to comply with its contracts and dealing with business partners who are unable to perform.

Whilst the direct health impacts of the coronavirus outbreak are largely affecting mainland China, the commercial impacts will be felt globally, with downstream and upstream implications coupled with the high level of interconnectedness of China with the global economy.

In this pack, we will discuss some of the most common issues that businesses are encountering right now. Our aim is to support businesses to comply with their obligations, and to make legally responsible decisions. It is critical in times of crisis to ask how today's decisions made in the heat of the moment will bear the test of time – say 3 years from now? Longer-term impacts beyond legal matters need to be factored in, such as community and regulator expectations.

This pack is not intended to deal with all circumstances, especially contracts or industries which may be regulated by specific laws. In particular, note that separate considerations will apply to employment contracts – a separate pack has been prepared for this purpose and is available at www.kpmglegal.com.cn.

Common contractual issues facing businesses in challenging times



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Approving and signing contracts

Regardless of how challenging the environment may be, businesses will do their best to run as smoothly as they can, both in terms of external and internal matters. For example, they may need to sign contracts urgently, but their business partner may be unable or unwilling to arrange a face to face meeting to sign. More significant contracts will often also require approval from a company's board of directors (and sometimes even shareholders), but nowadays frequent travel is a norm, and given travel restrictions during virus outbreaks it may not be possible to have everyone physically present at the same time.

Legal Considerations

1. The contract laws of both Hong Kong and mainland China are flexible in that they allow electronic signing of contracts, with some exceptions. You can discuss with your business partner on what type of electronic or digital signature is agreeable. What is most important is that the parties are able to show that the signature is appropriate and reliable and can prove that they have mutually agreed to be legally bound by a contract.
2. This approach applies to general commercial contracts, however there are certain exceptions for important documents that still require handwritten signatures. For instance, generally speaking under Hong Kong law this includes wills, certain trust documents, documents about land and property transactions, and powers of attorney, and under PRC law this includes documents involving marriage, adoption, inheritance, and suspension of supply of public utility services.
3. As for board or shareholder meetings, first examine your company's articles of association (its constitution) carefully. This document sets out rules on how your company should be run. Generally speaking, subject to those articles of association, you may host meetings virtually via telephone or videoconference, or you may also pass a written resolution instead of holding a meeting. In all cases, businesses must follow proper procedures under the applicable laws and your company's articles of association.

Complying with contractual time limits

Many commercial contracts contain requirements about time, such as for the service of notices, for payment terms, for termination, for the exercise of option periods, or for time extensions. How are those time periods affected by the coronavirus outbreak or other major events?

Legal Considerations

1. Many contracts use the concept of “Business Days” to count how much time you have to fulfil certain obligations. You should review the definition of “Business Days” and all the places in the contract where this term is used, and consider whether you can still meet those time limits. Generally, where the time limits under a contract is measured by reference to “Business Days” they will likely exclude public holidays, but other time limits measured by reference to “days” more generally may not.
2. This is significant because the PRC central government had extended the Chinese New Year public holidays until 2 February 2020. Certain PRC local authorities have also declared additional extensions of the holiday period until at least 9 February 2020. Therefore, if part or all of your contract involves performance in mainland China, it is likely that these extended public holiday periods may not constitute “Business Days”, as defined in the contract. This will in turn affect key parts of your contract such as the notice period, payment terms and performance period.
3. Meanwhile, the Hong Kong government has not declared any new public holidays yet, but has temporarily closed or suspended a number of public facilities and services, including postal services. This may cause delays to mail deliveries, but it is unlikely that businesses can argue that these were not “Business Days”.
4. In all cases, the precise effect will depend on the specific wording of your contract and where exactly the contract needs to be performed.
5. Finally, where there may be uncertainty from a contractual perspective, it is recommended to engage in proactive discussions with contracting parties – recognising the importance of longer-term relationships and the reality of the challenges faced by many businesses in the current environment. Our general experience is that proactive engagement with other contracting parties before a time limit may be breached can lead to improved negotiated outcomes than merely waiting for it to expire, especially for financing arrangements.

Suspending or terminating contracts

Virus outbreaks and other major events may disrupt supply chains, trigger cancellations and generally dampen the economic mood for investment and spending. Businesses under financial pressure may face challenges when trying to uphold their contracts. If they determine that continued performance is not possible, they may try to look for ways to suspend or terminate their obligations.

Legal Considerations

1. Commercial contracts will often have a force majeure clause to cover what happens under extreme situations. Under PRC law, force majeure is defined in statute as unforeseeable, unavoidable, and insurmountable objective conditions. Meanwhile, Hong Kong law emphasises the exact contract wording, where force majeure is usually defined as something beyond the parties' reasonable control, and certain types of situations are then listed out.
2. Based on precedents during the 2003 SARS outbreak, it is likely that the current coronavirus outbreak would be deemed a force majeure event by PRC courts pursuant to the PRC Contract Law. This may be helpful where the contract does not spell out what constitutes a force majeure.
3. However, a force majeure event does not, in itself, allow the parties to simply walk away from the contract. The obligations and liabilities of the parties will generally still need to be resolved based on principles of fairness. This is where it is critical to identify and document the extent to which the failure to perform the contract (or parts of it) is directly due to the coronavirus outbreak and compliance with related government announcements. All reasonable steps should be taken to mitigate loss, to perform parts of the contracts which can still be performed, and to perform the contract after the coronavirus related challenges are alleviated. Where non-performance is due to the failure of one of your suppliers (i.e. upstream effects) affected by the coronavirus outbreak, this should similarly be very clearly conveyed to your customer and documented.
4. For international contracts entered into by PRC entities, the China Council for the Promotion of International Trade has issued a notice advising that it may issue force majeure certificates for the coronavirus outbreak. Whether those certificates will be seen as having legal effect in international contracts will depend on the terms of the contracts themselves, as well as the nature and situation of the underlying transactions.

Dealing with potential breaches of contract

Despite the best intentions of business partners, it is possible that businesses will fail to meet their obligations under a contract and therefore technically be in breach. This is not an ideal situation for either party, however it is important to remain proactive and practical in finding a way out, and not necessarily resort to legal remedies immediately.

Legal Considerations

1. If you believe you may not be able to perform a contract due to the coronavirus outbreak, you should consider when it is realistically likely that you can resume being in compliance. Review the contract to assess the impact on you due to your non-performance. Communicate early with the other party on a good faith basis in an attempt to resolve the situation. Consider whether part of the contract may still be performed.
2. If your business partner is the one who may breach a contract, you should review the contract carefully to evaluate available options, and take all reasonable steps to mitigate your losses as far as possible. Consider whether failure of this contract may in turn affect your own performance under your other contracts, in which case you should also take the actions in paragraph 1 above.
3. In any case, you should document in writing all the circumstances leading up to the current situation. If both parties still want the contract to proceed, explore other options through good faith negotiations, for example time extensions, contractual amendments, or waivers of certain obligations. If you reach agreement on the way forward, do get it in writing.
4. If you can get results through a good faith negotiation, this is preferable to a formal dispute resolution process. It is important to preserve long-term business relationships and recognise that all businesses are facing difficulty in this environment. That said, if there are signs that the relationship is breaking down, consider whether you need professional advice about your legal rights to better inform your discussions with business partners.

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