

JUNHE SPECIAL REPORT



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Discussion on the legal basis for rent reduction during extraordinary times such as the Pneumonia Epidemic and further comments

Since the outbreak of COVID-19, in order to prevent and control the spread of the epidemic, the state and local government departments have issued a series of policies. For example, on January 24, 2020, the Hubei Provincial Department of Culture and Tourism issued the *Notice on Further Strengthening the Management of Cultural Venues and Cultural and Tourist Activities and Containing the Spread of the Epidemic* (hereinafter referred to as the "**Notice of Hubei Provincial Department of Culture and Tourism**"), requiring profit-making cultural and entertainment venues and business sites that had Internet access to suspend business. Even though shopping malls and various business premises in other areas were not forced to close directly, they suffered losses due to residents' avoiding going out and a reduction in customer flow. In this case, many real estate enterprises (Wanda, China Resources Land, Longfor, KWG Group Holdings, etc.) announced a rent reduction for their lessees. However, if the lessor(s) do not volunteer to reduce the rent, how can tenants make a claim for a reduction? We have studied this from a legal viewpoint and hope that the results will be helpful

when dealing with rent disputes caused by the COVID-19.

I. Judicial Practice of Rent Reduction Disputes during SARS

SARS in 2003 was an infectious disease that affected the whole country, in the same way as the current COVID-19. For the main lessees of commercial properties in retail, catering, education and other industries, they have had a similar impact. Thus, SARS's corresponding judicial practice provides great reference value. We have searched and analyzed cases nationwide in which tenants sued for rent reduction after the SARS period and summarize as follows.

a) The main reasons for the Court to support rent reduction during SARS were:

i. SARS was force majeure, so the rent was reduced according to law.¹

ii. The SARS epidemic was an unpredictable disaster. The economic losses

¹ (2018) Jin 04 Min Zhong No. 2272 Civil Judgment by Changzhi Intermediate People's Court.

caused by the suspension of business were objectively beyond the scope of market risk. Therefore, the rent could be reduced according to the principle of change of situation.²

iii. Both parties should bear the losses based on the principle of fairness (but in some cases, the courts failed to clearly explain the criteria of the principle of fairness).³

iv. SARS was a public health emergency. The lessee's business was suspended in accordance with the government's regulations, or its performance was affected as a result. Therefore, it was reasonable to reduce the rent as appropriate. However, in relevant cases, the courts did not explain the basis of the claim to reduce the rent as appropriate.⁴

v. The lessor shall reduce the rent according to the agreement between both parties.⁵

b) The main reasons for the Court not to support a rent reduction during SARS were:

i. The court held that SARS was not force majeure and that there was no basis for supporting a rent reduction. However, none of the relevant court decisions explained the reasons why SARS was not force majeure.⁶

ii. Although SARS was force majeure, the losses caused by SARS were within the scope of normal business risks. However,

none of the relevant court decisions explained why such losses were attributable to "normal business risks".⁷

iii. The claim for rent reduction during SARS exceeded the limitation of action.⁸

c) Case analysis

i. Most courts held that rent should be reduced during the SARS period, and the amount of rent reduction depended on the specific situation. (Among the nine cases in support of rent reduction during the SARS period, rents were judged to be exempted completely in four cases, by half in three cases, reduced according to the contract in one case and "reduced as appropriate" in another case.)

ii. The main reasons for supporting rent reduction during SARS were the principle of force majeure, the principle of change of situation and due to the parties' agreement, which will be further analyzed below.

iii. A minority of courts did not support rent reduction for the reason that the epidemic was not force majeure, or the epidemic was a part of normal commercial risk despite force majeure. However, in the relevant judgments, the court did not make any further explanation on the reason why the epidemic was not force majeure and the losses caused by the epidemic were a "normal commercial risk".

² (2018) Lu 06 Min Zhong No. 268 Civil Judgment by Yantai Intermediate People's Court; the legal basis is Article 26 of *Interpretation II of the Supreme People's Court of Several Issues concerning the Application of the Contract Law of the People's Republic of China* (see Paragraph 1, Part 2b).

³ (2007) Gui Min Si Zhong Zi No. 1 Civil Judgment by Intermediate People's Court of Guangxi Zhuang Autonomous Region, (2004) Hu Er Zhong Min Er (Min) Zhong Zi No. 354 Civil Judgment by Shanghai No. 2 Intermediate People's Court, (2008) Luo Min Zhong Zi No. 2021 Civil Judgment by Luoyang Intermediate People's Court; the legal bases are Article 4 of *General Principles of the Civil Law*, "In civil activities, the principles of voluntariness, fairness, making compensation for equal value, honesty and credibility shall be observed." and Article 5 of *Contract Law*, "The parties shall adhere to the principle of fairness in deciding their respective rights and obligations."

⁴ (2004) Hu Yi Zhong Min Er (Min) Zhong Zi No. 32 Civil Judgment by Shanghai No. 1 Intermediate People's Court, (2006) Fo Zhong Fa Min Er Zhong Zi No. 5 Civil Judgment by Foshan Intermediate People's Court, (2008) Shao Zhong Min Yi Zhong Zi No. 143 Civil Judgment by Shaoxing Intermediate People's Court

⁵ (2014) Xia Min Chu Zi No. 275 Civil Judgment by Xiamen Intermediate People's Court

⁶ (2004) Hu Yi Zhong Min Er (Min) Zhong Zi No. 1289 Civil Judgment by Shanghai No. 1 Intermediate People's Court, (2005) Sanya Min Yi Zai Er Zi No. 7 Civil Judgment by Sanya Intermediate People's Court

⁷ (2017) Ji 04 Min Zhong No.441 Civil Judgment by Liaoyuan Intermediate People's Court

⁸ (2011) Bai Min Chu Zi No. 107 Civil Judgment by The People's Court of Baixia District Nanjing

II. Comparison between Force Majeure and Change of Situation

From the viewpoint of the above cases, to change rental terms in lease contracts when the performance of such lease contracts is affected by infectious diseases such as COVID-19 and SARS, the rules of force majeure or change of situation in relevant laws can be used as the basis of the claim. Here is our analysis.

a) Factors Necessary to Constitute Force Majeure

According to the *General Principles of the Civil Law of the People's Republic of China* (hereinafter referred to as "**General Principles of the Civil Law**"), *General Provisions of the Civil Law of the People's Republic of China* (hereinafter referred to as "**General Provisions of the Civil Law**"), *Contract Law of the People's Republic of China* (hereinafter referred to as "**Contract Law**") and other relevant laws and regulations, force majeure means any objective circumstances which are unforeseeable, unavoidable and insurmountable; and no party shall bear civil liabilities arising from a failure to perform a contract or damage to a third party due to force majeure, unless otherwise stipulated by Law. The *Interpretation of General Provisions of the Civil Law the People's Republic of China*⁹ further explains the three necessary requirements of force majeure:

i. "Unforeseeable" means that the parties "generally have no ability to predict the occurrence of an event in accordance with the current technical level";

ii. "Unavoidable" means that the parties "have done their best", but "still can't avoid the occurrence of certain event";

iii. "Insurmountable" means that "all

possible measures have been taken", but "the consequences caused by the event still cannot be overcome".

In terms of a lessee's rent reduction request, we take the view in relation to the above three requirements that

i. For the requirement of "unforeseeable", we should judge whether the parties could foresee the occurrence of infectious disease or similar events subjectively when they carry out civil legal acts. Generally speaking, if the lease is signed after the date that the infectious diseases are officially announced and brought to the attention of the public, it does not meet the requirement of "unforeseeable". It is worth mentioning that at the end of 2019, the Wuhan Municipal Health Commission initially announced that "the epidemic situation is preventable and controllable, no obvious phenomenon of person-to-person spread of the epidemic was found, and no medical staff were infected". If the signature date on the lease was between the end of December 2019 when the news was announced, and the end of January 2020, both parties (except professionals or professional institutions) might have known about the occurrence of COVID-19, but it was difficult for them to predict the severity of the epidemic, the release of subsequent administrative measures, and the impact of the above-mentioned situations on the lessee's business. It may be controversial whether the requirement of "unforeseeable" can be met.

ii. There is no doubt that the outbreak of the epidemic and the release of the corresponding administrative measures cannot be avoided by both contracting parties

⁹ Edited by Li Shiqi, Director of the Legislative Affairs Commission of the Standing Committee of the National People's Congress, Law Press, April 2017.

objectively. Therefore, the requirement of being "unavoidable" is met.

iii. As for the requirement of "insurmountable", we should judge whether the parties have the reasonable possibility to overcome the impact of the epidemic and continue to perform the contract. It is worth considering that even if there is an infectious disease, in the case of a mall still being open for business, the lessor is still performing its main contractual obligations on the surface (i.e. providing the leased premises), and it is possible for the lessee to perform its main contractual obligations (i.e. paying rent). What is affected by the force majeure is mainly the reasonableness of the contract price, that is, whether the rent actually reflects the value of the leased premises.

In addition to the above requirements, we believe that Article 180 of *General Provisions of the Civil Law*, which stipulates that civil liability shall not be borne for failure to perform a contract due to force majeure, also emphasizes the direct causal relationship between the force majeure event and the failure to perform the contract. Even if infectious diseases like SARS and COVID-19 are identified as force majeure events, if they only have an indirect impact on the performance of the lease contract, or only bring some inconvenience to the performance, there is no direct causal relationship between the force majeure event and the non-performance of the contract, which is not in line with Article 180 of *General Provisions of the Civil Law*.

The civil judgment ((2017) Ji 04 Min Zhong No.441 by Liaoyuan Intermediate People's Court) mentions in Footnote 7 "although SARS was force majeure, the consequent losses were within the

scope of normal business risk". Although the court did not clarify the reason, we think it intended to explain that there should be a causal relationship between the force majeure event and the losses (otherwise, it is within the scope of "normal business risks", which are inherent in business activities, such as changes in supply and demand and price changes not reaching the level of abnormal changes according to the *Guiding Opinions of the Supreme People's Court on Several Issues concerning the Trial of Cases of Disputes over Civil and Commercial Contracts under the Current Situation* effective as of 2009). Although the *Notice of the Supreme People's Court on Effectively Conducting Trial and Execution Work according to Law During the Period of Prevention and Control of Contagious Severe Acute Respiratory Syndrome* (being effective from June 11, 2003 to April 18, 2013) (hereinafter referred to as the "**Notice of the Supreme People's Court**") has been repealed, it demonstrated the Supreme People's Court's opinion that, "disputes arising from the failure of contract performance directly caused by the adoption of administrative measures for the prevention and treatment of SARS of the government and authorities concerned or the fundamental failure of the parties to perform the contract due to the impact of the SARS epidemic shall be properly handled in accordance with the provisions of Article 117¹⁰ and Article 118¹¹ of *Contract Law* of the People's Republic of China." Article 117 and Article 118 are the relevant provisions of force majeure. We also note that the Liaoning High People's court refused to determine that the termination of the contract was caused by force majeure, on the grounds that the SARS epidemic and the notice of stopping wildlife business issued by the relevant government departments only affected part of the lessee's

¹⁰ Article 117 of *Contract Law* sets out that "A party who is unable to perform a contract due to force majeure is exempted from liability in part or in whole in light of the impact of the event of force majeure, except otherwise provided by law. Where an event of force majeure occurs after the party's delay in performance, it is not exempted from such liability. Force majeure under this Law means any objective circumstances which are unforeseeable, unavoidable and insurmountable."

¹¹ Article 118 of *Contract Law* sets out that "If a party is unable to perform a contract due to an event of force majeure, it shall timely notify the other party so as to mitigate the losses that may be caused to the other party, and shall provide evidence of such event of force majeure within a reasonable period."

business activities, which was not enough to cause the "direct" or "fundamental" non-performance of the lease contract.¹²

In the period of this COVID-19 epidemic, if the premises are placed in forced quarantine or the shops are forced to close (according to the *Notice of Hubei Provincial Department of Culture and Tourism*, for example), we think that for such tenants, their lease contracts cannot be performed at all, and there is a direct causal relationship between the performance failure and the force majeure event, causing the legal effects stipulated by the force majeure provisions. But for those tenants who have not been forced to suspend business and who may still operate their shops, whether they can directly claim for rent reduction based on the occurrence of force majeure events in the absence of the agreement needs to be analyzed in combination with the specific circumstances of the performance of the relevant lease contracts.

Finally, Article 107 of the *General Principles of the Civil Law*, Article 180 of the *General Provisions of the Civil Law* and Article 117 of the *Contract Law* only stipulate "no party shall bear civil liabilities" but does not entitle the contracting parties the right to change the contract. It is controversial whether the lessee can claim for a change of the rental terms on the legal basis of force majeure.

b) Application of Change of Situation

Article 26 of *Interpretation II of the Supreme People's Court of Several Issues concerning the Application of the Contract Law of the People's Republic of China*, issued in 2009, sets out the clause relating to situation change: "Where any major change which is unforeseeable when the parties enter into a contract, is not a business risk and is not caused by force majeure occurs after

the formation of the contract, if the continuous performance of the contract is obviously unfair to one party or the purposes of the contract cannot be realized, and a party request the people's court to modify or rescind the contract, the people's court shall decide whether to modify or rescind the contract under the principle of fairness and in light of the actualities of the case."

The conditions for applying the above Article are:

i. There must be events that change the situation, that is, the objective circumstances which are the basis for the execution and performance of the contract, have indeed changed.

ii. The occurrence of the changed situation shall be unforeseeable by the parties and is not a normal business risk.

iii. The occurrence of the changed situation cannot be attributed to both parties.

iv. The changed situation occurs after the establishment of the contract and before the completion of performance.

v. The risk degree is far beyond a normal person's reasonable expectation, and the risk cannot be prevented and controlled.¹³ It will be unfair to one party if the relevant contract terms continue to be performed.¹⁴

Paragraph 3, Article 3 of the *Notice of the Supreme People's Court* stipulates that "cases involving disputes of contracts under which, due to the SARS epidemic, one party's rights and interests will be affected greatly if the original contract is performed, may be handled in accordance with the principle of fairness and the specific situation." Generally speaking, the

¹² (2013) Liao Shen Er Min Kang Zi No. 14 Civil Judgment by Liaoning High People's Court.

¹³ Paragraph 3, Article 1 of Guiding Opinions of the Supreme People's Court.

¹⁴ Cao Shouye, *Understanding and Application of Circumstance Changes in the SPC's Interpretation of Several Issues of Contract Law (II)*, Journal of Law Application, Vol. 8, 2009.

principle of fairness is also the legal basis of the principle of change of situation.

Professor Han Qiang wrote in *A Study on the Typology of the Principle of Change of Situation*: "the consequences of epidemic diseases are more the difficulties of contract performance due to the change of market environment caused by epidemic diseases than the failure of contract purpose. For example, at the beginning of the outbreak of influenza A (H1N1), the state announced that traveling to Mexico was forbidden. At that time, the parties may terminate the travel contract because the purpose of the contract could not be achieved due to force majeure. However, if the tourism market shrinks due to the epidemic disease, which makes the hotel tenants unable to operate the hotel normally, it shall be regarded as a situation of difficult performance. In the face of such situation, it is obviously improper that for the judicial interpretation to exclude force majeure from the application scope of the principle of change of situation. The only way to make up for this legal loophole is for the judge to bring the difficult performance caused by force majeure into the adjustment scope of the principle of change of situation through the interpretation of the principle of good faith¹⁵." ¹⁶Professor Wang Liming also believes that the difficult performance of the contract caused by the sudden outbreak of SARS is unforeseeable for the parties of the transaction, and the risk of the outbreak of SARS may be attributed to the scope of change of situation.¹⁷

For most tenants who have not been forced to suspend business during the COVID-19 epidemic period, although the lease contracts have not reached the point of fundamental impossibility of performance, due to the sharp decrease of customer flow and the lessees' income, it is obviously unfair for the lessees to

continue to perform the rental terms of the original lease, or the lessees may have difficulties in performing the contract. We believe that for such tenants, it may be more persuasive to advocate that the COVID-19 epidemic constitutes a change of situation and further claim for rent exemption.

However, we would like to draw the readers' attention to the fact that according to the *Guiding Opinions of the Supreme People's Court*, to avoid affecting the normal order of market transactions, the people's courts are quite cautious about applying the principle of change of situation, and such application in individual cases shall be reviewed by the High People's Court (and even the Supreme People's Court if necessary)¹⁸. Compared with the legal remedy of force majeure which is to exempt the liabilities for breach of contract, the legal remedy of change of situation depends on contract modification, which depends more on the negotiation of both parties or the judgment of the dispute settlement organization and is more uncertain.

III. Summary and Suggestions

To sum up, from the perspective of legal theory, we tend to think that the force majeure rules stipulated by relevant laws can be applied to tenants whose business has been forced to suspend according to the policies which lead to the fundamental impossibility of the performance of the lease contract, and that the lessees can be exempted from the obligation of paying rent; for tenants whose business has not been forced to suspend but has been greatly affected by the epidemic, we tend to think that they can claim for a modification of the contract to reduce rent based on the relevant laws and regulations of the change of situation. However, from a practical perspective, the courts have always been cautious about the

¹⁵ Professor Han Qiang also mentioned in his article that the principle of change of situation is to adjust or even terminate contracts in response to the changed objective facts, so as to maintain fairness and justice in good faith.

¹⁶ Han Qiang, *A Study on the Typology of the Principle of Change of Situation*, Chinese Journal of Law, Vol. 32, 2003.

¹⁷ Han Shiyuan, *Force Majeure, Change of Situation and Termination of Contract*, Journal of Law Application, Vol. 11, 2014.

¹⁸ Notice of the Supreme People's Court on Correctly Applying the Interpretation II of Several Issues concerning the Contract Law of the People's Republic of China So As to Serve the Primary Objectives of the Party and the State (effective as of April 27, 2009).

application of the principle of change of situation. It remains to be seen whether such an attitude will be changed under this COVID-19 epidemic situation.

Based on the above analysis, our suggestions for signed lease contracts are as follows:

- i. Check the force majeure clause, the rent reduction clause and other terms in the lease contract to find out the contractual basis for claiming an adjustment / non-adjustment of rent.
- ii. Both lessors and lessees shall promptly take control measures to prevent infectious diseases and notify the other party, minimizing the impact of the control measures on the operation in the relevant leased premises (i.e. self-reliance).
- iii. The lessees who pay fixed rent (or turnover rent or fixed rent, whichever is higher) shall pay attention to save all evidence showing a sharp decrease of the relevant operating income.
- iv. Lessees shall request lessors to reduce the rent as soon as possible, and shall avoid making such a request after the time limit of rent payment has expired and they have already underpaid the rent in part or in whole.
- v. If the parties fail to reach an agreement on rent reduction, lessees shall claim the right in other ways in a timely manner. Although the limitation of action for the delay and refusal of rent payment under

General Principles of the Civil Law is one year, according to Article 188 of *General Provisions of the Civil Law*, such limitation under the COVID-19 epidemic situation should be three years.

vi. Based on our observations, during the period of SARS, the state and some local governments issued policies¹⁹ reducing the relevant taxes on the rental income of some tenants, reducing the tenants' rent for those who lease state-owned operational premises or allowing them to postpone payment. Both leasing parties (especially the lessees of the state-owned operational premises) are advised to pay attention to the relevant policies, and save lease and income statements during the epidemic period and the same period of last year, so as to apply for fee exemption or postponement in the future.

In the future, when negotiating a lease contract, we suggest that both leasing parties consider reaching an agreement on the rent adjustment terms when the customer flow is greatly reduced. Although such terms depend on the parties' flexibility and may be relatively difficult (for example, lacking in detail, the period or range of rent adjustment, etc.), but at least it leaves the parties a contractual basis for negotiation and adjustment in case of emergencies, which is helpful in avoiding disputes.

¹⁹ Such as *Notice of the Ministry of Finance and the State Administration of Taxation on Relevant Tax Policies Concerning Prevention and Control of SARS Epidemic in Beijing*, *Notice of Beijing Municipal Administration of State Land, Resources and Housing on Relevant Issues of Reduction of House Rent during the SARS Epidemic Period*, *Notice of Hangzhou Municipal People's Government on Several Policies of Reducing the*

Impact of SARS to Some Industries in Our City, *Notice of Ningbo Municipal People's Government on the Adoption of Support Policies for Some Industries during the Period of Preventing and Controlling SARS Epidemic*, *Notice of People's Government of Luohu District's Issuance of Specific Measures for Helping Hotels, Restaurants, Entertainment Enterprises, Travel Agencies and Other Service Enterprises to Reduce the Operation Difficulties Caused by SARS*.

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