

## Special Series regarding the legal impact of the COVID-19 Epidemic on the Real Estate Industry---Topic Two: the impact of the COVID-19 Epidemic on the performance of construction contracts

### I. Introduction

Since the outbreak of the 2019 Novel Coronavirus Disease Epidemic (hereinafter referred to as “COVID-19 Epidemic”), central and local governments have issued various policies requiring housing construction projects to postpone the resumption of work in order to control the spread of the COVID-19 Epidemic. For instance, the Beijing Municipal Commission of Housing and Urban-Rural Development issued *the Circular on the Prevention and Control of the COVID-19 Epidemic on Construction Sites* (《北京市住房和城乡建设委员会关于施工现场新型冠状病毒感染的肺炎疫情防控工作的通知》) on Jan 29, 2020, requiring all housing construction and municipal infrastructure projects in Beijing to resume construction or start new construction work only after February 9 (the 16th day of the first lunar month), 2020, and to implement a closed and centralized management area on the construction site, and in the living areas. This article makes a preliminary analysis from a legal perspective of the potential impact of the COVID-19 Epidemic on the performance of construction contracts reached between construction project owners and construction contractors. We hope that it can be useful for the resolution of disputes over construction

contracts caused by the COVID-19 Epidemic.

**II. If the construction project has not been completed and the completion date stipulated in the contract is after the outbreak of the epidemic, and the construction period is or has been delayed due to the epidemic, the contractor may claim to postpone the construction period, be exempt from the liability for breach of contract, and may require the developer to cover part of the expenses**

#### 1. The COVID-19 Epidemic constitutes force majeure

According to paragraph 2, Article 117 of the *Contract Law of the People's Republic of China* (hereinafter referred to as “Contract Law”), force majeure is defined as situations that are objectively seen to be unforeseeable, unavoidable and unconquerable. The outbreak of the COVID-19 Epidemic is a social emergency that was unforeseeable at the execution of the contract, and unavoidable and unconquerable during the performance of the contract. Therefore, the COVID-19 Epidemic is a force majeure event.

#### 2. The contractor may claim to postpone the

**construction period, be exempt from the overdue liability for the extended construction period, and may require the developer to cover part of the expenses**

According to Article 117 of the Contract Law, a party unable to perform a contract due to force majeure shall be exempt from liability in part or in whole in light of the impact of force majeure, except as otherwise provided by law. For instance, if a construction project could not be completed on schedule due to various reasons, such as government orders were issued to delay the resumption of work, migrant workers could not return to work on time, materials and equipment could not be purchased or transported due to traffic control, logistics restrictions and control by the government, or the construction site was isolated due to the discovery of the epidemic, then the contractor may claim for an exemption from liability.

Generally, the exemption and sharing of liabilities under force majeure is stipulated in the construction contract. For instance, according to Clause 17.3 of the Construction Contract (Model Text)(GF-2017-0201), the contractor may claim to postpone the construction period, and the developer and the contractor shall reasonably share the losses resultant from the extension. The contractor may require the developer to make the following payments:

- (1) Any damage to the permanent works, materials and equipment on the construction site, and any casualties and property losses of the third party resultant from the damaged

project;

- (2) Necessary salaries payable to the workers during the suspension period;
- (3) If the developer requires the contractor to accelerate the work, the developer shall bear the expenses for the acceleration of the work;
- (4) Expenses for the contractor to manage, clean, and maintain the construction project during the suspension period as per the developer's requirements.

In judicial practice, the Shanghai No.1 Intermediate People's Court (No. of Judicial Documents: [2005] Hu [1] Civil [2] [Civil] Final No.1755) and the Zhejiang Higher People's Court (No. of Judicial Documents: [2011] Zhe Civil Final No.34) held that the SARS Epidemic of 2003 constituted force majeure, thus, the construction period should be postponed.

In the current market, since the developer is generally in a more advantageous position during the negotiation, there are often clauses in construction contracts that limit the scope of force majeure and/or the scope of remedies available to the contractor. Considering that the impact of the COVID-19 Epidemic is broad and substantial, we suppose that, even though judicial rulings usually follow the principle of "where there is an agreement, the agreement shall prevail", the court may also moderately support the contractor's request from a fair and reasonable perspective when dealing with cases related to the COVID-19 Epidemic.

### **3. Determination of the suspension and**

## resumption dates

Since the outbreak of the COVID-19 Epidemic was during the Spring Festival and most construction enterprises had already started their vacation, the suspension date may be determined according to the construction contract, the suspension notice, the construction log, etc. The resumption date shall be determined by taking into consideration government documents (such as *the Notice on Prevention and Control of the COVID-19 Epidemic on the Construction Sites* (《北京市住房和城乡建设委员会关于施工现场新型冠状病毒感染的肺炎疫情防控工作的通知》)) which required all housing construction and municipal infrastructure projects in Beijing to resume construction or start new construction only after February 9, issued by the Beijing Municipal Commission of Housing and Urban-Rural Development), as well as the continuing impact of the epidemic (for instance, workers could not return to work as usual, materials and equipment could not be purchased or transported because of traffic control or logistics restrictions, etc.). To make the resumption date certain and clear, the developer should issue the resumption notice after the end of the epidemic. If the contractor claims that it cannot resume work on the earliest resumption date specified by the government or on the resumption date notified by the developer, the contractor shall collect evidence to prove that it cannot resume work on time due to the continuing impact of the epidemic (such as requesting that the supervision, supply, transportation and other departments provide documents to prove the failure of commencement or performance of the

contracts on time).

## 4. The obligations of the developer and the contractor

### (1) Obligations to notify and confirm

The party claiming force majeure shall give notice or give confirmation within the time limit agreed in the contract. However, the construction period may be postponed under special circumstances, even if the party fails to strictly perform the obligation of notification or confirmation within the time limit agreed in the contract. According to Article 6 of *the Interpretation of the Supreme People's Court on Issues concerning the Application of Law in the Trial of Cases Regarding Disputes over Construction Contracts for Construction Projects (II)*, the parties agree that the postponement of the construction period shall be confirmed by the developer or supervisor by issuing certificates and other methods; where a contractor, though without confirmation of the postponement of the construction period, is able to prove that it has applied to the developer or supervisor for postponement of the construction period within the time limit agreed upon in the contract and such postponement conforms to the contract, the court shall uphold the contractor's request for postponement of the construction period. Where the parties agree that the contractor's failure to apply for postponement of the construction period within the agreed time limit is deemed as not a postponement of the construction period, such agreement shall prevail, unless the developer agrees to postpone the construction period after the

expiration of the agreed time limit or the contractor presents a reasonable defense.

(2) Claim for indemnity according to the contract

The party claiming for indemnity shall send the notice of claim and submit the claim report within the time limit and procedures stipulated in the contract. For instance, according to the Construction Contract (Model Text)(GF-2017-0201), where the developer or the contractor claims for compensation, the relevant notice shall be issued within 28 days after it becomes aware, or should have been aware, of the occurrence of the event.

(3) Obligations to avoid and minimize losses

Each party shall at all times use all reasonable endeavors to avoid and minimize losses. For instance, both parties shall keep machines and equipment safe during the suspension, start or resumption of construction as soon as possible after the end of the epidemic. Both parties shall continue construction and avoid the construction site needing to be sealed off, by strengthening the epidemic prevention and control measures, and avoid the spread of the epidemic by strengthening the sterilization and protection measures.

**5. Termination of a contract due to force majeure**

According to Article 94 of the Contract Law, the parties to a contract may terminate the contract under the circumstance that the purpose of the contract is rendered impossible to achieve due to force majeure. But in judicial practice, for the purpose of maintaining the transaction, the courts usually require that contracts be terminated when

the effect of force majeure on the performance of the contract has reached the extent that the purpose of the contracts cannot be realized. For instance, according to the Construction Contract (Model Text) (GF-2017-0201), the developer and the contractor are both entitled to terminate a contract if the failure of performance lasts more than 84 consecutive days or 140 accumulated days due to force majeure.

**III. If the completion date stipulated in the contract was before the outbreak of the epidemic, and the completion was postponed due to the epidemic, the liability for breach of contract for the postponed completion shall be determined according to the contract**

According to paragraph 1, Article 117 of the Contract Law, where the force majeure occurs after one party's delay in its performance, the liabilities of the party shall not be exempt. If the agreed completion date of construction was before the outbreak of the COVID-19 Epidemic, and the construction was not completed on time due to reasons of the developer or the contractor, the default party shall not be exempt from liability of the overdue completion for the reason of force majeure, even if the epidemic occurred later.

**IV. If the epidemic breaks out during a defect liability period or a warranty period, force majeure cannot be applied to extend the above periods, but the party may be exempted from the liability of postponing the performance of contract obligations as the case may be**

After the construction is completed, accepted and delivered to the developer, the contractor shall bear the quality defects liability and warranty obligations to the

contractor's quality defects. Under the circumstance that the epidemic breaks out during the period of defect liability or the warranty period, whether the epidemic can be claimed to constitute force majeure and the relevant liabilities can be waived depends on whether the epidemic had an "unavoidable" or "unconquerable" effect on the performance of the contractual obligations.

Generally, there are clauses in the contract regarding the extension of the defect liability period. For instance, according to the Construction Contract (Model Text) (GF-2017-0201), in case of any defect caused by the contractor during the period of defect liability, the developer has the right to request an extension of the period of defect liability, but the extended period of defect liability shall not exceed 24 months. If there is no quality defect caused by the contractor during the defect liability period or warranty period, even if an epidemic breaks out during that period, the developer shall not claim for an extension of the above period on the basis of force majeure because there is no such situation that the contractual obligation cannot be fulfilled due to the epidemic.

If the epidemic breaks out during the defect liability period or the warranty period and a quality defect caused by the contractor occurs during the epidemic period, and the developer did not discover the defect and notify the contractor in time due to the epidemic, the developer may claim for an exemption from the liability of failure to notify in time on the grounds of force majeure; for such quality defect that occurs during the defect liability period or the warranty period, the contractor shall still be responsible to repair, indemnify, etc. in accordance with the contract.

If a quality defect occurs during the epidemic period

due to reasons attributable to the contract, and the contractor cannot examine the construction, the workers can't build, materials and equipment cannot be purchased and transported due to the epidemic, thus, the contractor can't make repairs on time, the contractor may claim for an exemption from the liability of failure to repair in time on the grounds of force majeure.

Under the circumstance that a contractor has received a notice about a defect from the developer before the outbreak of the epidemic, but the contractor failed to repair on time, even if the epidemic breaks out later, the contractor shall not be exempted from the liability for the reason of force majeure due to its breach of contract first, and shall still be liable for the delay in the repair.

**V. Where the price of materials, labor and other goods has risen due to the impact of the epidemic, or costs have increased due to the adoption of epidemic prevention and control measures, any price adjustments shall be determined according to the contract**

The increase of the cost of materials, labor, epidemic prevention, control measures and other expenses, although they are caused directly by the epidemic, they are not unavoidable or unconquerable to the performance of the contract, thus they are not deemed force majeure.

If costs and expenses have increased, if the contract contains price adjustment clauses, then the contract price could be adjusted according to the contract; if the price of the contract is fixed, then one party could ask to adjust the price under the principle of change of circumstances, when the price increase is beyond expectations and the continuous performance of the contract is obviously unfair to this party. According to

Article 26 of *Interpretation II of the Supreme People's Court of Several Issues concerning the Application of the Contract Law*, where any major change that was unforeseeable, was not a business risk and was not caused by a force majeure, occurs after the formation of a contract, if the continuous performance of the contract is obviously unfair to the other party or cannot realize the purposes of the contract and a party files a request for the modification or rescission of the contract with the court, the court shall decide whether to modify or rescind the contract under the principle of fairness and in light of the actualities of the case.

It is suggested that developers and contractors pay attention to collecting and fixing evidence related to the suspension and resumption of construction, procurement, transportation, the return of workers, and government control measures during the outbreak of the epidemic. They should collect evidence regarding the issuing of applications or instructions about the suspension or resumption of construction in a timely manner and in accordance with the construction contract, and take proactive measures such as notification, confirmation, and indemnity claims in accordance with the contract.

## **VI. Suggestions**

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