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Is There a Law in China Similar to the US Defense Production Act?

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Although there is no law or regulation in the People's Republic of China that explicitly parallels the US Defense Production Act of 1950 ("**DPA**"), as an economy with many remaining elements of state control, there are ample administrative measures, regulations and judicial precedents in China allowing the government to overrule outstanding production plans and contracts by mandating, controlling, allocating and prioritizing production of critical supplies. Thus, during the global COVID-19 pandemic, if a company is thinking of entering into contracts with Chinese manufacturers, government action is an additional risk that it needs to consider.

On March 18, 2020, US President Donald Trump issued an executive order ("**COVID-19 Executive Order**") declaring that "health and medical resources needed to respond to the spread of COVID-19, including personal protective equipment and ventilators" met the criteria set forth in the DPA to permit the use of the powers granted by the DPA.¹ On March 23, 2020, President Trump took an initial step under the DPA by issuing an Executive Order authorizing the Attorney General to investigate and prosecute hoarding of personal protection equipment and related price gouging.² On March 24, 2020, the administration went further, with FEMA administrator Peter Gaynor announcing that the agency would start using its DPA powers to procure about 60,000 test kits and began inserting DPA-specific language into its contracts for 500 million masks.³

Essentially, under the DPA, the US federal government is authorized to force a US manufacturer to prioritize government contracts ahead of existing contracts for supporting the government's COVID-19 response and to allocate materials, services and facilities in such a manner as to prioritize these contracts or orders over other contracts and orders. Companies that are required under the DPA to produce government orders in priority are protected from liability for failing to meet prior deadlines. The government's authority under the DPA is typically implemented through the Defense Priorities and Allocations System ("**DPAS**").⁴

China doesn't have any law like the DPA that overtly requires companies to prioritize the government's contracts ahead of existing commercial contracts. However, the Chinese government often uses administrative means to control epidemic prevention product manufacturing, which can have effects similar to the DPA. For example, during the COVID-19 crisis in early 2020, the Chinese central government issued multiple notices (i) requiring local governments to take charge of manufacturing epidemic prevention materials; and (ii) requiring manufacturers to obey the centralized arrangement:

¹ Executive Order on Prioritizing and Allocating Health and Medical Resources to Respond to the Spread of COVID-19 ([Executive Order 13909](#) of Mar. 18, 2020), see [here](#).

² See 50 U.S.C. § 4512; see also Executive Order on Preventing Hoarding of Health and Medical Resources to Respond to the Spread of COVID-19, Mar. 23, 2020, see [here](#).

³ Rebecca Ballhaus & Andrew Restuccia, Administration to Use Defense Production Act for First Time in Coronavirus Pandemic, Wall St. J., Mar. 24, 2020, see [here](#).

⁴ PART 700 - Defense Priorities and Allocations System (Feb. 1, 2020), see [here](#).

- On January 28, 2020, the People's Republic of China Central Committee (中共中央) issued the *Notice on Strengthening the Party's Leadership and Providing Strong Political Guarantee for Winning the Outbreak Prevention and Control Battle* 《关于加强党的领导、为打赢疫情防控阻击战提供坚强政治保证的通知》 – which states that party committees (party groups) at all levels should strengthen management and obey the central government's orders;
- On January 29, 2020, the General Office of the State Council of the People's Republic of China (国务院办公厅) issued the *Urgent Notice on Coordinating and the Resumption of Production of Epidemic Prevention and Control Key Material Production Enterprises ("Material Production Enterprise")*, 疫情防控重点保障物资生产企业 (《关于组织做好疫情防控重点物资生产企业复工复产和调度安排工作的紧急通知》) – which (i) mandates that the State Council of the People's Republic of China ("**State Council**") shall have the right to centrally manage and allocate "key materials" for epidemic prevention and control ("**Epidemic Key Materials**") and (ii) the State Council (or local government equivalent) shall send material security officers to such Material Production Enterprises to ensure the centralized management and allocation of such Epidemic Key Materials;
- On February 28, 2020, the National Development and Reform Commission of the People's Republic of China ("**NDRC**", 国家发展与改革委员会) issued the *Notice on Doing a Good Job in the Management of the List of Material Production Enterprise* (《关于做好疫情防控重点保障物资生产企业名单管理有关工作的通知》), requiring the local NDRC branch to make a list of and to supervise the Material Production Enterprise. If an enterprise manufactures key material for epidemic prevention and control ("Key Material", 疫情防控重点保障物资), such manufactures will register with the local NDRC branch and will be supervised by NDRC.⁵ Such enterprises will manufacture preferentially the government's contracts and enjoy state preferential policy treatment, e.g. tax, bank loan.

While there are no penalty rules established in these notices, these administrative pronouncements are regarded as mandatory.⁶

Government action has long been recognized under Chinese law as a potential objective event that could justify a "force majeure" defense to avoid contractual liabilities for non-performance of a contract or give rise to the right to terminate a contract.

Article 180 of the *People's Republic of China General Provisions of Civil Law* (formally adopted at the 5th Session of the 12th National People Congress of the People's Republic of China on March 15, 2017) ("**Civil Law**") states that:

⁵, the list of the Key Material refers to the *Letter on the Specific Scope of the Key Material* 《关于提供疫情防控重点保障物资具体范围的函》 issued by NDRC on Feb.18, 2020.

⁶ Jinan is accelerating the organization to increase market supply! Daily output of medical and daily masks 61,500 The daily output of disinfectant is 10.45 tons (济南正加快组织增加市场供应！医用、日用口罩日产量6.15万 消毒液日产量10.45吨) Feb. 06, 2020 – where the Information Office of Jinan Municipal People's Government acknowledged in their news conference that their epidemic prevention materials production is under the centralized control of the State Council. See [here](#).

“If a civil obligation cannot be performed due to force majeure, civil liability shall be avoided. If a more specific law provides otherwise, such provisions shall be followed. Force majeure refers to an objective situation that cannot be foreseen, is unavoidable and is insurmountable.”

Article 94 of the *Contract Law of the People’s Republic of China (Adopted at the Second Session of the Ninth National People’s Congress on March 15, 1999 and promulgated by Order No. 15 of the President of the People’s Republic of China on March 15, 1999)* (the “**Contract Law**”) states that:

“The parties may terminate a contract if (i) force majeure frustrated the purpose of the contract;”

Article 117 of the Contract Law also states that:

“If a contract cannot be fulfilled due to force majeure, the obligations may be exempted in whole or in part depending on the impact of the force majeure, unless laws provide otherwise. . . Force majeure as used herein means **objective situations which cannot be foreseen, avoided or overcome.**”

Please note that “force majeure” has not been clearly defined under Chinese law, and case law interpreting the factors that would be necessary to support a finding of “force majeure” defense is limited and sometime contradictory. A full discussion of the legal concept of “force majeure” under Chinese law is beyond the scope of this alert. However, we can refer to how similar questions were interpreted during the SARs epidemic in 2003 - the *Supreme People’s Court of China: Notice regarding the execution of relevant trials of the People’s Court according to law during the prevention and treatment of infectious SARS (Fa [2003] No. 72), abolished in 2013*⁷ (“**Supreme Court Interpretation 2003-72**”), provided that the administrative measures taken by the government and relevant departments to prevent and treat the 2003 SARS epidemic that caused parties to the contract to be unable to perform their contract shall be deemed to be “force majeure” or “force majeure events” under Article 117 and Article 118 of the Contract Law respectively. In addition, the Supreme People’s Court of China issued on April 16, 2020, its *Guiding Opinions on Several Issues Concerning the Proper Hearing of Civil Cases Involving the COVID-19 Epidemic (1)* (最高人民法院印发《关于依法妥善审理涉新冠肺炎疫情民事案件若干问题的指导意见(一)》的通知), whereby it clearly specifies that both the COVID-19 pandemic and the government prevention and control measures in response to the pandemic can be considered “force majeure” or “force majeure events” and if such measures directly cause the delay or frustration of a contract, Chinese courts are to deal with such disputes under the provisions of Article 180 of the Civil Law and Articles 117 and 118 of the Contract Law.

China may not have an overt law similar to the DPA where the government can claim priority for the manufacturing of certain critical materials during times of emergencies. However, it can easily (and has) achieve the same results by administrative means. Counter-parties contracting with Chinese manufacturers would do well to consider the following:

- Commercially, is there a risk that the Chinese manufacturers may be ordered by the government to produce certain goods? Is the Chinese manufacturer a Material Production Enterprise? If the counter-party is deemed to be a Material Production Enterprise, consider the commercial terms that may limit your exposure to the risk (e.g., adjust payment terms).

⁷ (最高法院：关于在防治传染性非典型肺炎期间依法做好人民法院相关审判执行工作的通知（法[2003]72号）

- How should you draft the force majeure clause in your contract? Consider the definition of “force majeure” under Chinese law and whether acknowledgements within the contract would help or hinder the establishment of certain factors under such definitions.
- Governing law and dispute resolution provisions applicable to your contract will affect how the “force majeure” clause will be interpreted. The “force majeure” defense is also interpreted differently among different people’s courts in China. Do you want your contract to be governed under Chinese law? If yes, where do you want your contract to be formed? If government under laws other than Chinese law, is that practical under the commercial circumstances and what is the definition of “force majeure” under that governing law regime?