COVID-19: When is a pandemic force majeure? And what should new force majeure provisions address?

Simon Rainey QC and Andrew Leung

31 March 2020

Overview

The COVID-19 outbreak was declared a pandemic by the World Health Organisation on 11 March 2020. Some six weeks before this, on 23 January 2020, China implemented a regime of lockdown measures in Wuhan and other cities in Hubei in an attempt to quarantine the foci of the outbreak. China is edging back to normalcy, while bracing for a second surge of cases. Elsewhere, the clampdown on global economic activity by national governments is widening and intensifying with the spread of the pathogen.

Inevitably, many parties are finding it increasingly difficult if not impossible to perform contracts pre-dating these extraordinary and turbulent times. A question increasingly being asked is whether the outbreak or its consequences amount to a force majeure event. Naturally, there is no one-size-fits-all analysis. All will turn on the specific terms of the force majeure clause, the effects of the relevant event on contractual performance, and whether there are alternative means of performance. In this article Simon Rainey QC and Andrew Leung highlight some of the relevant themes as declarations of force majeure due to COVID-19 proliferate.

Once again, China seems to be ahead of the curve: LNG importer CNOOC has declared force majeure on LNG contracts (see - The impact of Covid-19 on the energy & natural resources sector - Chris Smith QC), and the China Council for the Promotion of International Trade has started to issue force majeure certificates. The legal or evidential weight such certificates might bear under English law is a moot question. Certainly, they will not simply supplant the multi-stage enquiry undertaken by English Courts as to force majeure, though whether they might inhibit enforcement in China is another matter.

Force majeure clauses: the basics

A force majeure clause is a contractual term which regulates the consequences of supervening events beyond the parties' control on the obligations of one or both of the parties to the contract. Such clauses typically require a causal link between such events and performance, and provide for the consequences of the event on the parties' obligations. The event may result in the cancellation of the contract, excuse non-performance (whether in whole or in part), or entitle a party to an extension of time and/or to suspend performance.

In addition to fulfilling any procedural requirements such as the giving of notice, it is for the party relying upon a force majeure clause to prove the facts bringing it within the clause. The party must prove the following, and this checklist must be applied to any COVID-19 force majeure argument:

1. The occurrence of an event identified in the clause;
2. It has been prevented or hindered (as the case may be) from performing the contract by reason of that event;
3. Its non-performance was due to circumstances beyond its control; and
4. There were no reasonable steps that could have been taken to mitigate the event or its consequences.

We consider particular problem areas in the light of recent cases and the special challenges which the worldwide sweep of COVID-19 poses. Where does this leave parties entering into new contracts in drafting force majeure provisions?

(1) What *is* the relevant force majeure event?

"Force majeure" is not a term of art. Whether the viral outbreak falls within a force majeure clause will turn on the proper construction of the wording of the clause.

Contractual provisions commonly enumerate force majeure events, which may include a "pandemic" or "epidemic", potentially by reference to WHO classification or, more generically, "disease". It is unlikely that the pandemic in and of

itself will have had immediate ramifications on contractual performance. It is the knock-on effects which will be in issue, which gives rise to questions of causation (discussed further below). It is therefore the ripple effect of the disruption caused by the virus which will in almost all cases provide the relevant putative 'event'. For example, the virus decimates the population of a port and the port is closed by government order, preventing delivery of the contract goods: the 'event' is in reality the port closure or government lockdown. Or where the government makes no closure order but recommends port users are to be confined to essential imports only. There is no ban or embargo, just a voluntary self-policing scheme: what is the 'event'? Is there one at all?

Many force majeure clauses do not expressly include a "pandemic" or similar in the list of named events. They may instead refer to an "Act of God" – a term that has been subject to surprisingly scant attention in the force majeure context – or, more concretely, "quarantine", "embargo" or "government action". With daily changes in the legal and regulatory landscape as governments enact outbreak management measures, events of this nature will be invoked under force majeure clauses with increasing frequency.

(2) "Beyond a party's reasonable control"

Most force majeure clauses contain sweep up language such as "*any other cause beyond* [the party's] *reasonable control*". The COVID-19 outbreak itself is clearly capable of constituting such a cause. But again, is the secondary or tertiary effect produced by it such a cause, and which is the actual trigger for inability to perform?

In ***Aviation Holdings Ltd v Aero Toy Store LLC*** [2010] 2 Lloyd's Rep 668, which concerned a contract for the sale of a Bombardier executive jet aircraft, Hamblen J stated that a seller unable to deliver the aircraft on time due to a pandemic causing a dearth of delivery pilots would be able to bring itself within the wording of a force majeure clause which provided "any other cause beyond the seller's reasonable control".

This type of wording applies to causes beyond the reasonable control of the party or, where relevant, any other party to whom contractual performance of that party's obligation has been delegated: ***The Crudesky*** [2014] 1 Lloyd's Rep 1 (in which the first-named author appeared). That case involved a string of contracts for the sale and purchase of Nigerian oil, ending with the charterers of the MV "CRUDESKY". The parties in the string who had delegated their obligation to load the vessel to Total, the terminal operator, were unable to rely on force majeure to avoid liability for a six week delay caused when the vessel was detained due to Total's failure to obtain official loading clearance. Total was their delegate for the purposes of loading. Its decision not to use official channels to obtain loading clearance was within its reasonable control and, by extension, that of its principals.

It will be relevant to ask in transactions with supply chains interrupted by the pandemic whether the cause of non-performance was beyond the reasonable control of any party to whom performance was delegated. For instance, it may be doubtful whether a factory closure by a vendor acting voluntarily and independently of government diktat would qualify as a force majeure event vis-à-vis a seller who arranged to source goods from that vendor.

(3) Causation: the effect on performance

Once a party has established the occurrence of a force majeure event, the next criterion is establishing that the event had and/or is having the contractually stipulated effect on performance.

Where the clause states that a party is relieved from performance or liability if it is "prevented" from performing its obligations or is "unable" to do so, it is necessary to show physical or legal impossibility, and not merely that performance has become more difficult or unprofitable: ***Tandrin Aviation Holdings Ltd v Aero Toy Store LLC*** (supra.). The economic toll of the pandemic will therefore not suffice. Nor will a delay of several months due to a pause in production in the context of a multiple year contract. However, as ***Tandrin Aviation*** suggests, a lack of personnel without whom contractual performance cannot occur, e.g. crew to operate an oil rig under a hire contract for an oil rig, could qualify.

Further, a seller will not be entitled to rely on a "prevent" clause where alternative sources of supply remain available. In ***PJ van der Zijden Wildhandel NV v Tucker & Cross Ltd*** [1975] 2 Lloyd's Rep 240, the sellers of frozen Chinese rabbits were not entitled to cancel the contract which provided "should the sellers fail to deliver…or effect shipment in time by reason of war,

floor, fire or storm…or any other causes beyond their control". They had been let down by their Chinese suppliers, but this did not prevent them from performing by other means. By contrast, if it is not possible to perform by any alternative means after the original or intended means for performance becomes impossible, that is a classic force majeure case.

A distinction can be drawn with the less stringent requirement that the force majeure event should "hinder" or "delay" performance. In ***Tennants (Lancashire) Ltd v CS Wilson & Co Ltd*** [1917] A.C. 495, a clause in a contract for the sale of magnesium chloride gave the sellers the right to suspend performance due to contingencies beyond their control "preventing or hindering the manufacture or delivery of the article". The sellers' principal source of supply in Germany was cut off on the outbreak of the First World War. Though an English source remained available, the sellers were entitled to rely on the clause. A multi-national export prohibition due to the pandemic therefore need not eliminate all possible sources to potentially hinder the performance of a contract for the sale of goods.

(4) But for causation?

A further question which may arise is: what if, though the pandemic indisputably prevents performance, the party claiming the benefit of the clause would not have performed even absent the pandemic? Take an example of a counterparty already in deep financial difficulty who, before Corona, was suspected of being unable to perform the long-term contract or the next obligation when it fell due. Corona intervenes and prevents any performance of the contract, relieving the pressure on the counterparty, who then declares force majeure.

This was the position in ***Classic Maritime v Limbungan Makmur Sdn Bhd*** [2019] EWCA Civ 1102 (in which both authors appeared) (see "But you weren't going to perform anyway!": A new hurdle when invoking Force Majeure - Classic Maritime Inc v Limbungan Makmur SDN BHD - Simon Rainey QC and Andrew Leung). The contract was a long term contract of affreightment ("COA") for the carriage of Brazilian iron ore. The relevant contractual force majeure clause excluded liability for loss or damage "resulting from" a series of specified events, including one applicable on the facts, which "directly affect the performance of either party". The Samarco tailings dam-burst destroyed all means of the party sourcing Brazilian iron ore and prevented any possible performance of the COA. The non-performing party was in financial difficulties and had missed several shipments just before the dam-burst event as a result. It was held to be unable to rely on this clause despite performance having been rendered wholly impossible because, but for the dam burst, on the facts it would not have performed anyway.

This contrasts with the clause considered in ***Bremer Handelgesellschaft v Vanden Avenne-Izegem PVBA*** [1978] 2 Lloyd's Rep 109, which, once triggered, cancelled the affected portion of the contract. Being a "contractual frustration clause", the House of Lords held that there was no such requirement of "but for" causation as it automatically brought the contract to an end forthwith.

The antithesis between these cases suggests the nature of the remedy conferred by the force majeure clause (i.e. suspension or cancellation) may influence whether or not it is necessary to prove 'but for' causation.

(5) Avoidance / mitigation: working round the problem

The existence of reasonable steps the non-performing party could have taken to avoid or mitigate the effects of a force majeure event will preclude reliance on the clause. To take the example given above of the port closed as a result of COVID-19 affecting the population which prevents the normal route of delivering goods to the buyer. If it were possible to deliver at a neighbouring country whose ports were still open, and then carry the goods by rail or road to the delivery place, then reliance on force majeure would not be possible.

The burden on the party claiming force majeure is in this respect a heavy one. For example, in ***Classic v Limbungan*** it was held that the non-performing party had no means of avoiding or mitigating the dam-burst and its effect on supplies of Brazilian iron ore, but only after an exhaustive analysis (at summary judgment: [2017] EWHC 867 (QB)) of all possible sources of supply, including going into the market, buying afloat and shipping back to the Brazilian ports to reship and thereby perform the COA by this alternative route and, subsequently, a full debate in expert evidence (at trial) as to market quantities available: see e.g. [2018] EWHC 3489 (Comm). Faced with COVID-19 problems preventing the immediately

obvious means or manner of performance, a party may be faced with a much more expensive and inconvenient means of performing. If that is open to it, then it may later be unable to justify its invocation of force majeure. In practical terms, it makes sense to explore and document how there were no other alternative routes. In ***Classic***, the non-performing party had in part laid a proper paper-trail by seeking alternative supplies from the other supplier (Vale) once the supplier it was using (Samarco) closed its operations after the dam-burst and was able to show that Vale refused to make supplies available, preferring to service the needs of its established customers in time of dearth of supply.

Some contracts go further, such as that in ***Seadrill Ghana Operations Ltd v Tullow Ghana Ltd*** [2018] 2 Lloyd's Rep. 628 which contained an unusual express term requiring both parties to "use their reasonable endeavours to mitigate, avoid, circumvent, or overcome the circumstances of force majeure".

In the present COVID-19 context, the unprecedented nature of the measures being introduced by governments internationally is likely to narrow the scope for avoidance or mitigation. But it will not foreclose it altogether and expense and inconvenience are not enough, hence the importance of the focus on the precise wording: 'prevent' or 'hinder' etc.

(6) Looking ahead... future-proofing new contracts

Even in these troubled times, trade and commerce continue. New contracts face particular challenges in that they are concluded against the backdrop of the pressing current problems but also forecasts of continuing or extended lockdowns into the future and with the spectre of secondary outbreaks and recurrence of the virus next winter.

This calls for a careful review of the force majeure provisions contemplated for the new contract. Simple reliance on the last pre-Corona contract 'with logical amendments' or standard terms and boilerplate is unlikely to be sufficient or wise, unless the clause in question is a sophisticated one which covers some or all of the points raised above.

Plainly clauses which refer to "unforeseeable events" will be of scant assistance. To take the example of the NNPC Terms considered in ***The Crudesky***, these provided general wording which qualified the various listed events: "Neither the Seller nor the Buyer shall be held liable for failure or delay in the performance of its obligations under this Contract, if such performance is delayed or hindered by the occurrence of an unforeseeable act or event which is beyond the reasonable control of either party ("Force Majeure") which shall include, but not [be] limited to..." (emphasis added). COVID-19, its recurrence, and its mutations are now all unfortunately very foreseeable. Similarly clauses which are modelled on the civil law definition of force majeure (*imprévisible, irrésistible et extérieur*: unforeseeable, unpreventable and external) will leave the parties fully exposed. Thus the ICC Force Majeure Clause 2003, together with the requirements of causation of prevention of performance, the results of which could not reasonably be avoided or mitigated, requires the party *invoking force majeure* to establish also "that it could not reasonably have been expected to have taken the occurrence of the impediment into account at the time of the conclusion of the contract".

Obvious points to consider will include:

1. Moving away from prevention to hindrance or lesser thresholds for interruption or impedance of contractual performance;

2. Specific sub-clauses dealing with epidemic and the results of epidemic;

3. Addressing the threshold for "beyond reasonable control" in the light of the Court of Appeal's judgment in The Crudesky;

4. Building on, in addition to the traditional force majeure regime, more sophisticated provisions which can address the economic effect and increased costs of performance and alternative means of performance, such as "material adverse change" (MAC) or "material adverse effect" (MAE) clauses which allow termination of the contract, or suspension or adjustment of contract obligations, where external events impact upon the value of performance (although even these commonly do not extend to pure market or price movements).

SIMON RAINEY QC

ANDREW LEUNG

Simon Rainey QC

"Truly a super silk - devastatingly sharp, and exceptional on his feet." "As good as his reputation suggests." (Legal 500, 2020)

Simon Rainey QC is one of the best known and most highly regarded practitioners at the Commercial Bar. He has a reputation which is second to none for his intellect and legal analysis ("fantastically intelligent and tactically astute"). He is acclaimed for his advocacy skills ("a stunning advocate") and his cross-examination ("excruciatingly superb"). But he is equally well known to his clients as a cheerful team player, who rolls up his sleeves in long and complex trials and arbitrations and who prides himself on high standards of client care ("incredibly user friendly" and "lovely to work with").

His practice focuses on five core areas: commercial litigation, commodities and international trade, energy and natural resources; international arbitration; insurance and reinsurance and shipping and maritime law.

Winner: International Arbitration QC of the Year 2020, Legal 500 (and shortlisted 2017 and 2019). Winner: Shipping and Commodities QC of the Year 2017, both Chambers & Partners and Legal 500 (and shortlisted 2018; 2019; 2020). Winner: Top 10 Global Maritime Lawyers of 2017 (Lloyd's List); and again in 2019.

> view Simon's full profile

simon.rainey@quadrantchambers.com

Andrew Leung

Andrew is regarded as "an incredibly sharp junior advocate with an enormous capacity for hard work and the ability to consistently deliver under pressure" (Legal 500, 2020) and a "future star of the English commercial Bar" (Legal 500 Asia Pacific, 2019). He has a broad commercial practice which encompasses commercial dispute resolution, international arbitrations, shipping, energy, commodities, insurance and reinsurance, and banking and financial services. His notable ongoing and recent experience includes:

» ***VTB Commodities Trading v Antipinsky Refinery (Petraco Oil Company SA intervening)*** (see e.g. [2020] EWHC 72 (Comm)) (led by Simon Rainey QC and Louis Flannery QC), proceedings involving allegations of fraudulent double-selling and diversion of oil cargoes, with claims and counterclaims worth c.US$90m.

» ***Classic Maritime v Limbungan*** [2019] EWCA Civ 1102 (with Simon Rainey QC), a dispute arising out of the collapse of the Samarco tailings dam in Brazil in 2015. Now the leading case on force majeure (on appeal from [2018] EWHC 2389 (Comm)).

» A 5-week arbitration involving a >US$500m dispute under a contract for the construction of a deep sea drill ship giving rise to issues as to deliverability, contractual termination and whether the buyer was responsible for delaying the project (with Duncan Matthews QC and Christopher Smith).

> view Andrew's full profile

andrew.leung@quadrantchambers.com