

Coronavirus outbreak

The legal implications

February 2020

Companies globally are being impacted by the coronavirus outbreak, through both the labor market and their supply chain. Travel restrictions on Chinese workers are preventing the normal resumption of work after Chinese New Year and affecting the operation of manufacturing plants within China as well as the Chinese labor market outside China.

The shutdown of Chinese manufacturing is likely to have an impact on the global supply chain along with a consequential impact on construction projects and other downstream industries. Disruption may spread indirectly to other markets, including key commodity markets (copper, iron ore, zinc, nickel, lithium, oil and LNG). In particular, many mines in emerging markets rely upon the free movement of people, in and out of country, who rotate their work shifts on a periodic basis. With a significant proportion of mines having Chinese personnel, this creates a high risk of spread. We are already seeing restrictions on travel affect construction and operation activities on mine sites in Africa for example.

The shipping industry is likely to be impacted in a number of ways: not only through disruption to voyages to and from China, but also from delays in other countries as a result of quarantine and port checks due to cases, or suspected cases, of the coronavirus amongst crew and passengers on board vessels. Delivery of cargo may be delayed, or cargo may need to be discharged at alternative or interim ports, with expensive consequences and significant logistical and insurance implications. The construction of newbuilding vessels and scheduled ship repairs and upgrades are being delayed as a result of the impact of outbreak on the Chinese workforce which could adversely affect operating schedules. There have already been press reports that Chinese energy companies may be considering rejecting scheduled LNG cargoes claiming force majeure as national demand weakens.

As well as investigating the contractual implications, effective work health and safety systems and strategies for workers, sites and the wider community should be put in place to preserve business interests and to ensure the safety of workers while plans for business continuity should also be implemented to allow for the recovery of operations if required. These plans will need to be developed globally, particularly in the maritime industry, where strategies around the safety of crew and passengers aboard vessels and the potential impact on any destination ports of outbreaks of the virus during voyages will need to be addressed.

The rights of employees and users of services must not be overlooked. Although the outbreak of the coronavirus has been declared a global health emergency by the World Health Organization, response must be reasonable and proportionate so as not to affect human rights enshrined in the Universal Declaration of Human Rights. The right to health provides for the right to access healthcare, the right to access information, the prohibition of discrimination in the provision of medical services, and the freedom from non-consensual medical treatment. Arbitrary detention or discrimination will give rise to potential claims. Quarantines or restrictions on the right to freedom of movement imposed (as opposed to voluntarily entered into) must be proportionate, safe and respectful. They must be imposed in a non-discriminatory way for legitimate aims and not targeted at people of select race or origin.

We consider below some of the relevant contractual provisions and risk management strategies which may be invoked in the wake of the crisis. Whilst the analysis below focuses on the position under English law, similar considerations are applicable in other jurisdictions. Our global teams are already advising on these issues in a number of jurisdictions.

A force majeure event?

Affected parties should consider whether their contracts make provision for force majeure clauses and whether the outbreak falls within the protection offered by the relevant clause. Force majeure¹ events are, broadly speaking, unexpected circumstances outside of a contracting party's reasonable control that, having arisen, prevent it from performing its contractual obligations.

Release from performance as a result of force majeure is not recognized as a standalone principle of English common law. It is therefore a matter for parties to deal with expressly in their contracts and the protection afforded by the clause will depend on the precise drafting. In the event of a dispute as to the scope of the clause, the English courts will apply the usual principles of contractual interpretation.

In the construction context, the internationally used FIDIC Conditions of Contracts define "Force Majeure"¹ as an exceptional event or circumstance which is beyond the control of the party affected and which the party affected could neither have foreseen or provided against before entering into the construction contract nor avoided once it had arisen. The event must also not be the fault of the other party.

The FIDIC Conditions contain an illustrative list of the sorts of exceptional events and circumstances that may constitute force majeure events. Subject to providing the requisite notice, the contractor may be entitled to an extension of time and/or recovery of costs incurred as a result. If the exceptional event is prolonged, the option of termination may arise. However, many FIDIC contracts are heavily negotiated and amended. The contractual clauses will therefore require analysis and the occurrence of a force majeure event will depend on the circumstances of the case. For example, in the absence of a relevant authority imposed curfew or strike action, a worker's decision not to show up for work is unlikely to be sufficient to justify suspension of performance.

If the outbreak constitutes a force majeure event under a construction contract, employers could be faced with contractors (and contractors with sub-contractors and suppliers) claiming they are entitled to invoke provisions in their contracts and to suspend performance. If the contract contains cost protection measures that relate to force majeure events, employers could also be faced with claims arising from the impact of the outbreak. Depending on the terms of the agreement, the affected party may be under an obligation to mitigate the effects of the event, sourcing materials or workers from elsewhere. Questions of concurrent claims may also arise, adding complexity to the analysis.

In the maritime sector, there have already been reports that Chinese shipbuilding yards have declared force majeure under some of their shipbuilding contracts as a result of the delays caused by the outbreak. The force majeure clause and the surrounding circumstances will need to be evaluated on a case by case basis, as will the effect of any resulting disruption in planned employment for the vessel.

Not all contracts will have force majeure provisions: for example charterparties may not have these clauses, although they will contain other provisions specifically drafted to deal with situations where the voyage is affected by an infectious disease (such as the BIMCO Infectious or Contagious Diseases Clause) which may be triggered and/or relevant as a result of the outbreak. These contracts will require additional consideration as to the nature of the impact of the outbreak on the contract and the effect that this might have on the parties.

Frustration?

Under English law, if a contract becomes impossible to perform as a consequence of the outbreak, it may be open for a party to argue that it has been frustrated. The financial consequences of a contract being frustrated are complicated but the parties are discharged from further performance of their obligations. However, it is difficult to establish frustration. In particular, it cannot be used (a) where the parties have contractually agreed the consequences of the supervening event (for example by the use of a force majeure clause), (b) an alternative method of performance is possible, (c) because performance has become more expensive or (d) because a party has been let down by one of its suppliers.

Implications under funding arrangements?

Businesses affected by the outbreak will also be reviewing their credit agreements to assess the implications under the terms of these agreements with funders.

It is likely that funders will require the provision of information under their (often wide) information undertakings. If the loan is not fully drawn, the parties will be examining whether the circumstances will result in a draw-stop, particularly if force majeure has been triggered under key contracts for the business or project. Ongoing analysis will be required to determine whether any event of default has been triggered. Credit agreements, particularly in construction financings, will include events of default for abandonment or suspension of construction works, for failure to achieve construction milestones or to progress the works, and, may also include a material adverse change clause.

¹ In the 2017 edition of the FIDIC Rainbow Suite, the term "Force Majeure" has been replaced by "Exceptional Events"

Ultimately whether or not the impact of the outbreak constitutes a material adverse change for the purposes of a representation and warranty, condition precedent or event of default is a matter of contractual interpretation. Material adverse change clauses are not standard. For example some relate only to a material adverse change in the ability of a counterparty to meet its obligations under the relevant contract, others are far more extensive and are triggered by a material adverse change in a counterparty's overall financial condition or in its business or prospects.

It is unlikely that the fact a counterparty is located in an area which is affected by the outbreak would of itself constitute a material adverse change in its financial condition (although, depending on the surrounding facts, it might have a material adverse change in its prospects). However if a counterparty subsequently experiences financial difficulties as a consequence, then that deterioration in financial condition could constitute a material adverse change in its financial condition. It has been held that for an event to be material it must (a) not be temporary and (b) significantly affect the party's ability to perform its obligations under the contract. It is not known how temporary the outbreak will be and, in any event, a temporary event may have permanent consequences. To establish a material adverse change is inevitably going to be a highly subjective process involving careful consideration of the drafting and surrounding circumstances.

Nonetheless where a counterparty is suffering financial problems as a result of the outbreak, it is likely that other contractual provisions will also be triggered, such as a breach of a financial covenant, a payment default or the failure to perform an obligation. It would be much easier to rely upon and enforce those more specific contractual provisions than to argue that a material adverse change has occurred.

Practical steps

The potential business disruptions from the outbreak cannot be underestimated given the importance of Chinese exports, labor and demand for goods to the global economy.

Risk management measures which corporates should consider include:

- Inserting express infection disease/epidemic wording into new contracts (and amending existing contracts if possible).
- Checking the terms of existing contracts for protection, including force majeure clauses.
- Check insurance arrangements – especially where cargo is delivered to an interim port or to some other port.
- Conducting risk assessments, considering factors specific to suppliers and working conditions.
- Keeping up-to-date with details of the affected areas through WHO's Disease Outbreak News.
- Ensuring proper training and providing information and education on the virus for the workforce including how the virus spreads, how to prevent the virus in order to prepare workers and how to dispel myths, fears and misconceptions.
- Auditing suppliers and reviewing their respective work health and safety systems and policies, especially relating to virus and disease control, ensuring they are up to date and appropriate, or requiring compliance with applicable company policies on the subject.
- Engaging with safety managers and ensuring there is continual and ongoing communication with workers, providing updates on the outbreak and training refreshers and drills as and when required.

Norton Rose Fulbright's global teams are actively advising clients in relation to the coronavirus outbreak. Please do not hesitate to get in touch with your Norton Rose Fulbright client contact if your business has been affected.

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