

Force Majeure or Supplier Defect/Contractor Obligation?

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Business interruptions due to the recent coronavirus outbreak (COVID-19) have significantly affected product supply chains and major construction projects in not only Asian countries that focus on manufacturing but also in Europe and regions that are involved with China's Belt and Road initiative (BRI). These effects are largely due to disruptions in the labor force, shipping logistics, and availability of raw materials.

Due to these limitations and the subsequent business impact, a large number of Chinese manufacturers have invoked force majeure,¹ a common clause in contracts that essentially frees both parties from liability or obligation when an extraordinary event or circumstance beyond the control of the parties, such as a war, strike, riot, crime, or an event described by the legal term act of God.²

Reportedly more than 3,000 of force majeure certificates have been issued to Chinese firms since the beginning of February by the China Council for the Promotion of International Trade (CCPIT). The certificate is a form of legal documentation for firms to help them renegotiate terms with overseas clients. We are also starting to see construction contractors in the Association of Southeast Asian Nations (ASEAN) countries entering negotiations and discussions with investors and beneficial parties because of the recent events.

There is, however, an ongoing debate as to whether the current COVID-19 crisis actually constitutes a force majeure event. Some legal commentators take the view that a fundamental problem with trying to categorise COVID-19 as a force majeure event is that it does not necessarily pass the unforeseeability test. These commentators note that, particularly in Asia, COVID-19 is not significantly different from SARS in 2003, Bird Flu (H5N1) in 1997, or MERS in 2012 and therefore should have been foreseeable. This view may be valid as long

as the impact of COVID-19 is generally the same as the previous events. However, the bigger and longer the impact of the COVID-19 crisis becomes, the more likely it will be that the consequences can be distinguished from those suffered previously and significantly exceed them, at which point they could be said not to have been foreseeable. Regardless, all parties who entered into a contract should equip themselves with the capability to differentiate, both legally and technically, the range of contributions to a supplier/contractor failing to fulfil orders or manufacturing products that result in poor performance or defects.

Consumer Product Manufacturing

For example, a battery raw material supplier, such as a mining company or a supplier of electrode coating materials, may seek to invoke force majeure due to the coronavirus when the battery manufacturer realizes that the product contains excessive contaminants that severely affected the performance of the end product. This type of dispute typically involves legal arguments complemented by support from experts providing:

1. An engineering and scientific analysis on the nature, scope, and the severity of the failure
2. Thorough technical due diligence of the cause-and-effect story of virus outbreak to introduction of contaminants in the shipment.

¹ <https://www.scmp.com/economy/china-economy/article/3052277/coronavirus-doubts-raised-over-whether-chinese-companies-can>

² https://www.trans-lex.org/944000/_/force-majeure/

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The analyses involved in supplier disputes are often relatively straightforward. They typically involve visiting a factory to gather data on the production line and manufacturing process to look for contribution (or lack thereof) of the alleged contaminants and perform product testing to correlate the actual failure mechanism to potential root cause contributors. For example, if it is determined that the manufacturing line has significant wear-and-tear due to lack of maintenance over a period outside of the virus outbreak, and if the contaminants can be tied to this issue, the case for the supplier invoking the force majeure clause in the contract becomes much weaker.

Construction and Engineering Projects

The recent COVID-19 crisis has also highlighted the vulnerability of supply chains on international construction and engineering projects. Force majeure clauses are common in many standard international contracts, such as the FIDIC suite of contracts. A typical force majeure clause is set out below:

“Force Majeure” means an exceptional event or circumstance:

- (i) *which is beyond a Party's control;*
- (ii) *which such Party could not reasonably have provided against before entering into the Contract;*
- (iii) *which, having arisen, such Party could not reasonably have avoided or overcome; and*
- (iv) *which is not substantially attributable to the other Party...”*

The underlying logic of a force majeure clause in a construction and engineering contract is that, when an event occurs which is unforeseen, the risks and consequences are shared equally between the parties. For example, under many force majeure clauses (including the one referenced above), a force majeure event allows the contractor additional time to complete the project, but the contractor cannot recover the costs

of the additional time. The risks and consequences are therefore shared between the owner, whose project will be late, at no cost, but will be unable to claim liquidated damages, and the contractor who will be allowed to complete late without the risk of incurring liquidated damages but who will have to cover its costs arising out of the delay. Ultimately, what constitutes a force majeure event and what happens after it depends on the specific terms of each agreement.

As a result, construction and engineering projects at this time may be assisted and facilitated by experts in the following ways:

- Audit projects to understand their current status in terms of programme and cost to enable parties to identify ongoing issues unrelated to COVID-19.
- Monitor projects going forward and identify the time and cost implications solely arising out of the COVID-19 effect.
- Provide independent opinion as to the true extent of delay and additional cost arising from COVID-19.
- Support parties in any disputes arising as to the root of project delay and cost overrun.

Summary

Engineering analysis by a third party expert is a powerful tool that allows the parties to get an unbiased perspective on the true nature of the event and, in some cases, takes away the need for formal litigation or arbitration and can reduce the overall cost of dispute resolution by presenting facts early on. This practice is especially effective when the assessment is a result of an integrated, multi-disciplinary effort. Exponent's global team has extensive experience and in-depth knowledge in many sectors, from consumer electronics, food, and automotive, to infrastructure, oil and gas, and environmental industries and can be easily leveraged to support disputes in various different stages.

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