

Dispute Resolution

## **FAQ on COVID-19 and its Potential Impact on Contracts**

### **Introduction**

The COVID-19 outbreak has been a jarring development across the world, particularly in Asia where the number of confirmed infections is the highest. The World Health Organisation has declared the outbreak a global health emergency, while in Singapore the Ministry of Health has (as of the date of this article) raised the risk assessment of the outbreak to Disease Outbreak Response System Condition ("DORSCON") level orange.

As the threat continues to climb, the impact of the outbreak has been palpable. National borders have been restricted, entire industries have been affected and businesses have found themselves having to change the way they work. This has heralded much uncertainty in the commercial world.

With the shifting circumstances, many commercial entities are struggling to find their feet. The performance of commercial agreements may easily be affected by the outbreak, whether it be due to obstructions in the supply chain, travel and import restrictions, human resource impediments or issues of demand. One of the primary questions being asked is what will happen to affected contracts. Will they have to be terminated? Will their obligations be suspended? Or will parties just have to endure the losses?

In this Update, we look at some of the common questions regarding the potential legal impact of the COVID-19 outbreak on contracts and agreements. This includes a focus on force majeure, frustration and the obstructions which may arise in specific industries such as Shipping & International Trade, Construction & Projects, and Hospitality and Tourism.

### **What is Force Majeure?**

A force majeure clause is a common contractual clause which provides for what should happen upon the occurrence of certain specified events. These events are situations over which the parties have no control and which might impede or obstruct the performance of the contract.

What constitutes a force majeure event depends on the terms of the agreement. Parties have the freedom to specify the applicable force majeure events – if certain events are not provided for, then courts are unlikely to deem them force majeure events, even if such events are clearly beyond the control of the parties. Common force majeure events in contracts include natural disasters, war, terrorism, and acts of government.

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What happens upon the occurrence of a force majeure event also depends on the terms of the agreement as well as how the event has obstructed performance of the contract. The force majeure clause may provide for the complete termination of the contract upon certain events. Alternatively, the clause may provide for a suspension of contractual obligations for the duration of the obstruction, an extension of time, a release from liability or even renegotiation.

### What is Frustration?

Frustration is conceptually related to force majeure. A contract is frustrated when unforeseen events occur which, outside the fault of either party, render the performance of the contract radically different from what the parties intended such that the contract is incapable of being performed.

When a contract is frustrated, the parties are discharged from further obligations under the contract.

Unlike force majeure, frustration is a common law concept which does not have to be specifically provided for in a contract. Therefore, if an event which obstructs the performance of a contract is not listed as a force majeure event, it may still constitute an event of frustration.

### Can My Contract be Terminated Because of the COVID-19 Outbreak?

This question can be broken down into two other questions:

- (a) Does the outbreak constitute a force majeure event?
- (b) Does the outbreak frustrate the contract?

As highlighted earlier, what constitutes a force majeure event depends on what is listed in the contract under the force majeure clause. If "epidemic" is one of the listed force majeure events, then the COVID-19 outbreak could well qualify. The outbreak may also potentially be come within the definition of "natural disasters", or even "acts of government", particularly if the obstruction arises from any government measure implemented in response to the outbreak.

A likely relevant factor is the apparent severity of the epidemic and the scale of government response, particularly in the lockdown of the Wuhan province, the travel restrictions implemented across the globe and local quarantines which have been imposed. Further, on 30 January 2020, the China Council for the Promotion of International Trade announced that it would be offering force majeure certificates to Chinese companies unable to fulfil their contractual obligations with foreign counterparts due to the outbreak.

However, it must be noted that force majeure clauses are generally drafted to apply only if the event causes some "disruption", "obstruction" or "prevention" of the fulfilment of the contractual obligations. It would hence be questionable if the outbreak has only caused inconvenience or an increase in price in the fulfilment of the contractual obligations.

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In considering whether the outbreak constitutes a force majeure event, and its legal effect, questions arising would include:

- (a) What are the events listed in the force majeure clause in the contract?
- (b) Does the outbreak potentially fall within one of these categories of events?
- (c) Has the outbreak caused some form of impossibility or commercial impracticability in the fulfilment of the contract?
- (d) Does the force majeure clause provide for the complete termination of the contract, the temporary suspension of obligations or otherwise?

As to whether the outbreak frustrates the contract, a key consideration would be the impact of the outbreak on the performance of the contract.

Increased expense, mere delay or onerousness in the performance of the contract resulting from the outbreak may not suffice. There ought to generally be a radical or fundamental change in the required performance of the contract in light of the outbreak.

Examples of frustration which may arise from the outbreak include:

- (a) Changes in the law which render performance impossible;
- (b) The subject matter of the contract (or something necessary for performance) has become unavailable; and
- (c) The stipulated method of performance has become impossible.

## How Does the Outbreak Affect My Industry?

Whether force majeure or frustration applies to a commercial arrangement depends very much on the circumstances of the case. Depending on the industry and the nature of the contract, the impact of the COVID-19 outbreak can vary greatly.

Here, we take a look at the potential impact of the outbreak and its resultant measures on specific industries.

### Shipping & International Trade

The shipping industry has perhaps been one of the hardest hit by the COVID-19 outbreak. China is home to some of the world's busiest ports, but the outbreak has seen lines rerouting cargoes and reducing calls to Chinese ports. Schedules have also been greatly affected by manpower issues, due in no small part to port and warehouse employees being unable to attend to their duties, meaning that ships encounter significant delays getting into and out of ports.

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The level of backlog and delay has also been exacerbated by entry and exit restrictions, as ships that have called at Chinese ports face quarantine periods before they can enter countries such as Singapore and Australia.

More detailed force majeure clauses may include such "disruption", "quarantine" and "entry restrictions" as force majeure events. Even if it does not, the obstruction of shipping routes and the various delays may be grounds for invoking a force majeure clause. Further, parties may seek to rely on the doctrine of frustration if their trade routes are rendered impracticable, or the delays become extreme or indefinite.

The massive shutdown in China has also had a severe impact on its demand for commodities and raw materials. China is the world's largest consumer, and its reduction of import capacity is thus even more keenly felt. China National Offshore Oil Corp, China's biggest buyer of liquefied natural gas ("LNG"), has already declared its intention to invoke force majeure on certain LNG supply contracts, citing the epidemic as the cause of its inability to import the LNG.

With the precedent set, more importers could seek to invoke force majeure on their supply agreements. This would depend largely on how far the effects of the outbreak have rendered them unable to receive deliveries of cargo.

### Construction & Projects

The construction and projects industry has also seen disruption due to the COVID-19 outbreak. China is heavily involved in this industry, with Chinese contractors being responsible for a large proportion of projects both locally and internationally. Chinese companies are also major players in terms of power generation facilities.

Chinese construction professionals and labourers have been a significant presence in projects not just in China but across the globe. However, the movement of Chinese citizens has been greatly curtailed. Countries have begun to impose quarantines or restrictions on entry on individuals who are from China, have been to China within the recent period, or have had contact with such individuals.

Additionally, the supply chain for construction materials has been subject to obstruction. Wuhan, the epicentre of the outbreak, is located in Hubei, one of China's manufacturing hubs. With the shutdown of the city, the production and supply of essential building materials such as steel and copper has been effectively halted.

The shortage of manpower and materials is likely to lead to delays in the completion of projects, if not outright impossibility of completing the projects as specified. In an industry where timelines are of particular importance, this may in certain situations be sufficient to constitute frustration or force majeure.

Further, several commonly-used standard form contracts in the construction and projects industry expressly provide for force majeure as grounds for an extension of time. These include the SIA Articles

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and Conditions of Building Contract and the REDAS Design and Build Conditions of Contract. Should the outbreak be found to constitute a force majeure event, parties to such agreements may be able to suspend their obligations so as to avoid liquidated damages. Notably, the Building & Construction Authority has also taken the initiative to issue a circular advising contractors involved in public sector projects to assess if their work progress has been delayed due to the impact of the outbreak. The contractors are advised to submit appropriate claims for extension of time if so affected.

## Tourism & Hospitality

The industry most immediately affected by the outbreak is likely to be the tourism and hospitality industry. Numerous countries have issued travel restrictions against visitors from China or who have travelled to China, and most commercial air carriers have reduced or suspended routes to and from China.

Singapore has also been heavily hit in this regard, with the Singapore Tourism Board projecting a 25-30% drop in visitor arrivals. Much of this is due to the fact that Chinese tourists account for one in five visitors to Singapore. Further, travel advisories have been issued by a number of countries advising against non-essential travel to Singapore due to the number of diagnosed COVID-19 cases here.

A question likely to be in the minds of those in the hospitality, tourism and retail industries is the legal effect, if any, of the outbreak, and whether a situation of force majeure or frustration has arisen.

There may be instances where the performance of a hospitality or tourism related contract is rendered impracticable by the outbreak. For example, we may expect the cancellation of events, particularly for international attendees, due to restrictions on travel and health and safety concerns for large gatherings. Labour shortage may also be a factor should staff absenteeism progress to an extent that the performance of obligations is no longer possible.

## Concluding Words

Businesses are likely to soon feel the impact of the COVID-19 outbreak. The waves have already begun to rock the proverbial boat in certain industries, and the tides only seem to be gaining momentum.

Parties should thus be aware of the potential effect of the outbreak and the related government measures on their contracts and commercial arrangements. In particular, parties should assess the potential applicability of force majeure clauses or frustration, whether as an option on their part or as pursued by their counterparties.

For further queries, please feel free to contact our team below.

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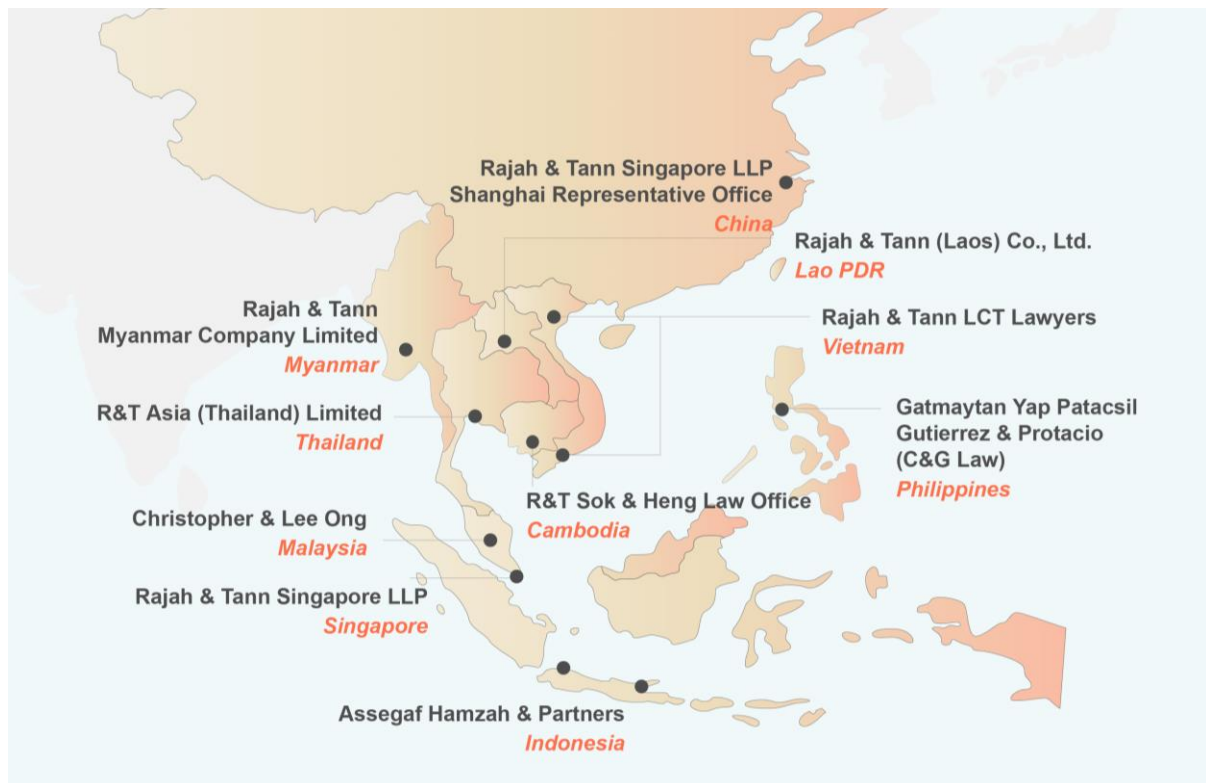
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