



Supply chain issues arising from Covid 19 and their ramifications

By Angus Withington

1. Supply chain issues can arise from political judgments to control the pandemic leading to a tightening of regulations for the protection of public health and the need to insulate important sectors from future disruption.
2. Disruption can be expected particularly in respect of transport between countries and delays at border controls or quarantine requirements.
3. Two aspects to be considered in this paper:
 - (1) Force Majeure clauses
 - (2) Business interruption clauses

Force Majeure

4. This concept arises only where there is an express force majeure clause in the relevant contract – it will not be implied. The most relevant principles are that:

- (1) it is for the party who wishes to cite a Force Majeure event to prove the facts which bring the contractual clause into effect (ie. proving that there is a specified event beyond its control);

(2) that party must also prove that it has been prevented from performing the contract by reason of that event. In most cases, this can only be done by showing either a legal or physical impossibility. The fact that circumstances might render an event to be commercially disadvantageous or uneconomic will not sufficient;

(3) that party must also show that there were no reasonable steps which could have been taken to mitigate the event or its consequences; and

(4) there must have been adherence with any notification requirements specified in the contract.

5. Unlike frustration – which automatically terminates the contract – a force majeure clause will excuse non-performance.

6. Force majeure clauses may have a significant impact in the context of COVID-19.

7. Four issues to consider:

(1) the key is to scrutinise the clauses to see whether the present health crisis falls within their scope;

(2) some standard clauses make reference to pandemic, epidemic or disease;

(3) other clauses can refer to governmental intervention. There is likely to be a relevant distinction between government advice and mandatory requirements. eg. it is not presently unlawful for employees to work within two metres of another person—although the strong advice is that any nearer contact should be avoided. Such a restriction is therefore unlikely to qualify as a relevant event for a force majeure clause; and

(4) if examples of force majeure in a contract do not make any express reference to economic factors, then an attempt by a party to rely upon financial problems caused by COVID-19 are unlikely to be accepted as a force majeure event.

8. Causation is also likely to be a significant issue.

(1) it is normally necessary for force majeure event to be sole cause of cancellation – and that the party seeking to be excused performance to not be at fault.

(2) whilst Covid-19 may be a factor in non-performance, it may not be the only issue. eg. a company may have been struggling for different reasons and facing insolvency in any event, eg. Flybe.

(3) *Classic Maritime Inc v Limbungan Makmur Sdn Bhd* [2019] EWCA Civ 1102: the Court of Appeal held that a supplier was not able to rely on a force majeure clause because the relevant clause required the supplier to prove that it would have been able to perform the contract but for the force majeure event.

9. Mitigating losses

(1) Reasonable need to mitigate any effects of COVID-19. This will of course be fact sensitive – but courts are likely to expect to see measures such as enhanced sanitation, remote working etc being adopted first.

(2) Furloughing of employees may give an enhanced financial position for companies – but it is unlikely to be considered as an excuse for the non-performance of contractual obligations.

Business Interruption

10. Different types of insurance policies:

- cover losses caused by restrictions imposed as a result of a notifiable disease; and/or
- cover losses caused by physical damage to premises.

11. Contingent Business Interruption policies also provide cover for losses arising from disruption to a company's supply chain e.g. a key supplier who is subject to quarantine.

12. For all types of cover – the key consideration is obviously the wording of the policy. Issues to note include:

(1) Many policies will refer to specified diseases. COVID-19 is unlikely to be one of them. There may be an argument that it could fall within a wide definition of a specified disease or is a variant of one – expert evidence would probably be required; and

(2) Alternatively, the cover may be broad, capturing “notifiable diseases” – which is a common wording. In England & Wales, Covid-19 became notifiable on 5 March 2020. Losses before that date will usually be excluded from recovery.

13. The fact that COVID-19 is new and could not have been anticipated means there are likely to be challenges to the interpretation of insurance policies which were drafted without it in mind.

Causation

14. If Business Interruption is cover included as part of a property damage policy, it will probably be necessary to show damage to premises. More extensive

policies might also cover damage caused to premises by the pandemic onsite (eg. if contamination has occurred). In relation to the latter, an Insured will still be required to prove that it would have been able to continue trading had the outbreak not taken place at the workplace:

(1) so there will be no claim if a business was not able to trade anyway because of the lockdown restrictions; and

(2) if there is still a claim, Insurers are likely to succeed in argument that income/profits would have decreased in any event because of the wider effects of the pandemic.

15. It is worth remembering that evidence gathering to support a claim can be difficult as companies in a company's supply chain may choose not cooperate – if the relationship is not sufficiently close to facilitate a sharing of information or if personnel are not available to assist (eg. as a result of redundancies or furloughing).

16. The requirement to mitigate loss is likely to prove one of the most contested issues by Insurers – even in absence of express requirement under the policy.

17. Businesses might therefore need to show that they have been prepared to alter their working practices to try and overcome lockdown constraints, eg. restaurants offering take-aways, different working practices in factories etc.

18. If claims are successful – the recoverable loss may well prove to be less than the actual losses sustained.

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