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CORONAVIRUS: SUPPLY CHAINS ARE BROKEN, NOW WHAT? – A LEGAL EVALUATION OF FORCE MAJEURE CONCEPT DURING AN EPIDEMIC

"***This is not a drill.***

This is not the time to give up.

This is not the time for excuses.

This is a time for pulling out all the stops."

World Health Organization Director-General's remarks regarding coronavirus at the media briefing on 5 March 2020

Beginning from the New Year's Eve of 2020, the world lives under the shadow of an unknown disease, now infamously called coronavirus which was first detected in Wuhan, China. Coronavirus has had a significant impact on human health which also triggered a mass mania in the public leading to sold-out hygiene materials in some counties. World Health Organization recently announced that there are now more than 110,000 reported cases of coronavirus (*also known as COVID-19*) globally and the spread has caused more than 4,000 deaths. 80% of the cases outside China are reported just from three countries: the Republic of Korea, the Islamic Republic of Iran and Italy. Most countries have been partially or completely closed down.

Cologne, Germany on 29 February 2020

English translation: '*Dear customers, the disinfection materials are no longer available due to the current situation. We are working intensely towards restoring the availability of goods. Thank you for your understanding.*'

Businesses are not exempt from these chaotic circumstances and feeling the burn. The traditional supply chains are broken as China, the second largest economy of the world, is struggling to get back to work. China being the manufacturing hub of the world and a dominant resource of raw materials, the current outbreak of coronavirus originating from its lands affects global supply chains of goods. Plus, governmental measures taken in response to coronavirus epidemic have created a serious impact on businesses as these measures have resulted in worker shortages, transportation restrictions, disrupted supply chains and suspended manufacturing facilities. The after-effects are mostly seen in the sectors of manufacturing, construction, commodity markets, energy and tourism. Stock markets were also down,

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the biggest fall since the global financial crisis, and oil prices plunged by around 30%, the biggest fall since 1991.

For this post, we have evaluated the after-effects of coronavirus from the contractual point of view and tested whether the parties can rely on force majeure concept under different set of laws and legal instruments.

Before moving on to the examination of contracts, we need to establish what force majeure means:

An event beyond the control of the parties preventing a party to fulfill its contractual obligations. That said force majeure clauses and their scope may vary from contract to contract.

The supply contracts are the ones most affected by the virus which we have selected as the center point of our study. But there is also another elephant in the room: *performance-based contracts*. Operation and maintenance contracts are deeply affected due to travel restrictions issued by governments. There are also contracts entailing both sales and performance obligations of the parties which would be affected by the current situation.

Recent outbreak of coronavirus epidemic is also a reminder for the parties to review their force majeure clauses and to check whether they cover these kinds of unexpected events in today's rapidly changing world. Bear in mind that the wording of the contract and the choice of law become more important in case of crises such as the one caused by coronavirus. Further, most international supply or performance-based contracts include effective dispute resolution clauses and most of them refer the disputes to international arbitration. Here it may be worth to mention that some arbitration rules, such as International Court of Arbitration of International Chamber of Commerce, also known as ICC, London International Court of Arbitration and Singapore International Arbitration Centre provide for emergency relief mechanisms if the parties wish to receive an order of an interim relief or conservatory measures. An emergency relief may be sought from the emergency arbitrator with an aim to block a claim from a party affected by the coronavirus regarding its release from its contractual obligations and to request the preservation of status quo.

In the below chapter, we have created a checklist on how to determine whether force majeure concept can be triggered due to the coronavirus outbreak. We highly recommend that the parties affected from coronavirus in one way or another should consult their legal advisors before taking any steps as force majeure concept and the consequences thereof vary under the specific circumstances surrounding the case.

CHECKLIST ITEM 1:

DO YOU HAVE A FORCE MAJEURE CLAUSE IN YOUR CONTRACT AND WHAT DOES IT COVER?

As force majeure is a contractual concept that relies on the wording of the contract, the said clauses generally define force majeure events by setting certain criteria to be fulfilled. In most cases, force majeure is defined as an event that is beyond the control of the parties, is unreasonable to expect its prevention which, at the same time, substantially influences parties' performance of contractual obligations. In common law, force majeure is not usually implied into contracts, thus the parties must expressly provide force majeure as an excuse for non-performance. On the other hand, civil law jurisdictions apply the doctrine of force majeure into contracts implicitly regardless of the absence of force majeure clause in the contract.

Force majeure clauses generally require that the performance of the contractual obligations must be impossible as a result of the event, not simply more burdensome. They may also bring additional

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requirements to declare force majeure, such as duty to notice the counterparty in a reasonable time period when force majeure event is occurred and, more importantly, duty to mitigate the losses.

Most of the force majeure clauses provide a list of examples of force majeure events, among such there are natural events such as act of God, pandemics, earthquakes and hurricanes. Force majeure clauses may also include a catch all phrase like "*any other events beyond the parties' control*" while providing a list of force majeure events. On the other hand, parties may also exclude certain events from the scope stating that events like financial turbulence or strike do not constitute force majeure.

According to the news, the Chinese Council for the Promotion of International Trade ("**CCPIT**"), affiliated with the Chinese Chamber of Commerce has started to issue certificates of force majeure upon the requests of Chinese companies affected by COVID-19. CCPIT has issued more than 3,000 certificates of force majeure corresponding to a contract value of more than $40bn up to the present. However, these certificates do not have any legally binding effect on the parties since they only constitute a factual proof showing that the relevant party is struggling due to coronavirus outbreak. Still, the legal effect of such certificate depends on the specific terms of the contract, applicable law and specific objective circumstances of a case.[i]

CHECKLIST ITEM 2:

NO FORCE MAJEURE CLAUSE IN THE CONTRACT – WHAT DOES GOVERNING LAW SAY?

Sometimes contracts do not include a force majeure clause, but most contracts entail a provision of governing law. In the absence of force majeure clauses in the contract, a party may rely on the governing law to argue the existence of such and be released from its contractual obligations.

UN Convention on Contracts for the International Sale of Goods ("**CISG**") stands as the most relevant legal instrument in terms of international sales. CISG is applicable to contracts of sale of goods between parties whose places of business are in different states (i) when the states are contracting states or (ii) when the rules of private international law lead to the application of the law of a contracting state. Article 79 of the CISG governing the damages provides that a party is exempted from paying damages if the breach is due to an impediment beyond its control. This impediment could not have been reasonably foreseen at the time of the conclusion of the contract or the party could not reasonably avoid or overcome the impediment or its consequences. Accordingly, Chinese parties, especially the ones located closer to the center of the epidemic may argue that coronavirus is an impediment beyond its control.

China is a contracting state to the CISG and if the other party's place of business is in different contracting state of CISG, such as Turkey, Article 79 finds application to the extent that coronavirus' effect can be interpreted as an impediment beyond control. In practice, most supply contracts exclude the application of CISG. However in cases where there is only a mere reference to laws of a contracting state, CISG may still be applied.

If the agreement is silent about the governing law, it will be determined via the international private law rules. Most of the conflict of law provisions state that the law which has the closest link to the subject matter of the contract will be applicable. For instance, this connection point is also defined as the characteristic performance in the Turkish International Private and Procedure Law. Characteristic performance is the primary obligation of a party that distinguishes the contract from other types of contracts, for instance the act of selling is a characteristic performance in a sale contract. Accordingly, if a Swiss company buys electronic goods from a Chinese manufacturer and there is no governing law clause (assuming that they explicitly excluded the application of CISG), their contractual relationship will be evaluated as per the Chinese law.

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If the rules of applicable international private law point to a civil law country, the doctrine of force majeure will be applied to contracts implicitly. If the contract is governed by Swiss law, a party is liable for damage caused by the non-performance of its obligations under the contract, unless it can prove that the non-performance was due to reasons beyond its control. According to Swiss case law, force majeure events are extraordinary "external" events related to natural forces or actions of third parties which are unexpected and unforeseeable to both parties, and which cannot be prevented by applying due care. The closest concept related to force majeure is the concept of impossibility of performance. The impossibility can be argued in cases where the contract becomes impossible to perform after it was formed.

Not surprisingly, similar to Swiss law as it has been adopted, force majeure is not defined in Turkish Code of Obligations ("**TCO**"). In the TCO there is no statutory definition for force majeure. Rather, the parties may rely on articles concerning the impossibility of performance (Articles 136, 137 and 138 of TCO). If the performance of contractual obligation becomes impossible due to a reason which is not attributable to the obligor, the obligor shall be released from performance as per Article 136 of TCO. In Turkish case law, there are several high court precedents which determine epidemics as force majeure events or mentioned epidemics as force majeure events. In one of its decisions, the General Assembly of Civil Chambers of Court of Appeal stated that "[…] *force majeure is occurred beyond the control of obligor and cannot be foreseen or prevented which inevitably causes non-performance such as earthquake, flood, epidemics.*"[ii]

Further, an epidemic is explicitly listed as a force majeure event in the Turkish Public Procurement Contracts Law numbered 4735. Accordingly, the Turkish public entities which have concluded contracts with counterparties being affected by coronavirus such as China or Italy as per the said law, both parties may as well rely on force majeure and may terminate the contract or request time extension. However, it should be emphasized herein that there is no case law specifically dealing with such case.

CHECKLIST ITEM 3:

AFTER FORCE MAJEURE IS ESTABLISHED – ARE YOU RELEASED FROM YOUR CONTRACTUAL OBLIGATIONS?

Once it is established that coronavirus falls under the concept of force majeure, one must also evaluate the consequences of force majeure on contractual obligations.

If a force majeure event occurs within the context of contractual definition, a typical conclusion is to release the party facing force majeure from performing its contractual obligations. Moreover, there are examples of force majeure clauses which provide more concrete articles on the duration of non-performance. Some clauses provide termination as a consequence of force majeure under certain circumstances as well. In case of performance-based contracts, it may be hard to argue that such contracts can be terminated due to coronavirus if the epidemic shows any slow-down in the upcoming months. Any slow-down may well be interpreted as a temporary situation and would only result in the suspension of contractual obligations.

Under CISG, if a seller claims that coronavirus can be interpreted as an impediment beyond control, the buyer may choose to exercise its rights such as to avoid the contract under the CISG, apart from claiming damages and any other right involving the delivery of the goods.

Under Swiss law, performance must be objectively impossible, and the obligor must not be responsible for the circumstances rendering performance impossible. Only by fulfilling these requirements, parties may be released from their contractual obligations as per the Article 97(1) and Article 119 of the Swiss Code of Obligations.

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Under Turkish law, unless the obligor dully and timely notifies the creditor on the impossibility of the performance of the obligations and takes necessary precautions to prevent the increase of loss, the obligor shall be liable for the compensation of the related losses. TCO also provides adoption or revocation of contracts under Article 138 of TCO stating that the obligor may request for adaptation or revocation of the contract from the court or arbitral tribunals in case an unexpected event which was unforeseen and not expected to be foreseen by the obligor, should occur after the execution of the contract. Should Turkish law apply to the contractual relationship, a seller affected by coronavirus such as China, Italy or other European countries may not be liable for damages to the extent that the performance becomes impossible due to coronavirus. Again, it should be emphasized here that all circumstances surrounding the case shall be evaluated diligently by the parties before bringing any claims related to force majeure.

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[i] For China Council for the Promotion of International Trade's announcement, please see: http://rzzx.ccpit.org/news-ssyw?id=170.

[ii] General Assembly of Civil Chambers of Court of Appeal's decision dated 27.06.2018 and numbered E.2017/90 and K.2018/1259 and accessible via: https://www.lexpera.com.tr/ictihat/yargitay/hukuk-genel-kurulu-e-2017-90-k-2018-1259-t-27-6-2018.