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PERSPECTIVE

What if contracts are breached due to the coronavirus?

By Matthew S. Ingles

The outbreak of coronavirus disease has infected tens of thousands of people in China and escalating numbers in at least two dozen other countries, including the United States. In addition to its devastating impact on public health, the coronavirus carries with it wide-ranging ramifications for businesses around the globe.

If the rapid spread of the epidemic continues, the disease — designated COVID-19 by the World Health Organization — could become the first pandemic — that is, the worldwide spread of a new disease — of the 21st century. The director of the National Institute of Allergy and Infectious Diseases, Dr. Anthony Fauci, acknowledged the risk on Feb. 11: “Is there a risk that this is going to turn into a global pandemic? Absolutely, yes,” Fauci said.

More than two weeks after China locked down Wuhan in Central China to curtail the outbreak, one of the world’s largest economies and production centers continues to operate at reduced levels. Many of its factories and millions of its workers remain sidelined, suggesting that it could be weeks or months

before the Chinese economy returns to scale. In the meantime, the global economy continues to decelerate as a result of China’s containment efforts, measures which have prohibited workers from returning to their jobs and cut off factories from their raw materials.

The immediate result is a slowdown that is slashing traffic along the world’s shipping lines and leading to forecasts of a sharp decline in production of everything from tech products, to cars, to fashion. Apple’s iPhone production, which is heavily reliant on China, is predicted to drop by up to 10% in the first three months of the year. Earlier this week, Nissan stated that it would shut down one Japanese production facility for four days due to supply shortages of parts from China. Fashion companies, many of which rely on Chinese factories to make garments and supply fabrics and other materials, have warned investors that sales will decline. Many finished products are now stuck in China because little is being shipped out by water or air, creating a significant log jam at China’s ordinarily busy ports.

One inevitable longer-term consequence of the coronavirus outbreak will be missed

production, shipping, and supply deadlines, resulting in thousands of breached contracts. Will parties have a legally valid justification for missed deadlines that are tied, directly or indirectly, to this pandemic? That may depend on the wording of the *force majeure* clauses likely contained in each of those contracts.

Force majeure clauses are common in supply, production, and shipping contracts, and operate akin to the common law defense of impossibility, an affirmative defense for the failure to perform a contractual obligation. A typical *force majeure* provision contains specific excuses for a party’s delay or failure to perform, such as acts of God, war, government regulation, terrorism, natural disaster, and labor strikes, in addition to a catch-all provision for other emergencies beyond the parties’ control. To determine whether an event, such as the coronavirus pandemic, falls within the catch-all provision, courts will consider the intent of the parties, whether the event was foreseeable when the contract was entered into, and whether the event or its effects were beyond the breaching party’s control.

Courts have been clear that unforeseen increases in

cost to perform and drastic declines in demand are not sufficient to qualify as a *force majeure*, but they have not yet addressed whether a global pandemic constitutes a *force majeure*. While the contractual language contained in a particular *force majeure* clause will control the outcome of any given case, business should look to invoke the catch-all provisions of their *force majeure* clauses to defend against claims of breach, focusing on the unpredictable nature of this pandemic and the uncontrollable actions of the Chinese government in response. ■

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