THE IMPACT OF THE NEW CORONAVIRUS (COVID-19) ON INTERNATIONAL CONTRACTUAL OBLIGATIONS: FORCE MAJEURE UNDER ENGLISH LAW

In recent years, the import of liquefied natural gas ("**LNG**") by China has seen strong growth in absolute terms and has accounted for a significant proportion of the growth in global LNG trade[1]. Depending upon wider economic growth projections, China is shortly expected to overtake Japan as the largest importer of LNG.

In an environment of LNG production ramping up to meet lower carbon impact targets and significant new infrastructure being built, any down-turn in the imports of an important baseload buyer will have a strong impact in the market[2]. In particular, new US projects are heavily reliant on Chinese demand with China having pledged to spend an additional $50 billion on energy products in the recent Phase 1 trade deal with China[3].

Currently, the LNG market is therefore experiencing a supply glut at a time when Europe has full gas storage and new sources of pipeline gas are hindering its ability to maximise further demand. China's demand profile has been affected by a slowing of growth at the same time as the Power of Siberia pipeline has added 38 billion cubic metres of gas supply to the Chinese market[4]. The tragic effect of the Covid-19 virus looks set to contribute to this market uncertainty.

The evolving epidemic is already said to have accounted for the cancellation of several LNG cargoes in February 2020 and there is concern that this may continue[5], not just in respect of deliveries to China directly but through into the wider LNG and gas markets.

A large proportion of international gas and LNG delivery contracts are governed by English law and so it bears examining both the expectations of the parties and the underlying concepts enabling one (or both) parties to be excused from performance of their contractual obligations for reasons of force majeure.

As we set out in this briefing, depending upon the governing law and upon the specific terms used, there are potentially good arguments for both the Covid-19 event being effective as a reason to excuse or suspend performance and, also, for it not being a strong claim. This briefing aims to take a balanced position.

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[1] In both 2017 and 2018, China posted the largest ever single year growth in demand for LNG *(International Gas Union 2019 annual report)*

[2] China accounts for 16.7% per cent., or about 1 in 6 cargoes of LNG demand as of 2018 *(IGU 2019 annual report).*

[3] As announced by US Department of Trade on 15 January 2020, in Article 6.2(c) of the Economic and Trade Agreement between the Government of the United States of America and the Government of the People's Republic of China. It is important to note that "energy" in this context can cover crude oil and refined products and not just LNG.

[4] Deliveries from the eastern section commenced in December 2019. https://www.gazprom.com/press/news/2019/december/article493743/

[5] The Spanish utility, Naturgy, is reported to have cancelled several US-sourced cargoes in the last week. https://www.bloomberg.com/news/articles/2020-02-20/lng-buyer-cancels-cargo-from-biggest-u-s-exporter-amid-glut

THE CONTEXT OF FORCE MAJEURE UNDER DIFFERING LEGAL REGIMES

It is important to note at the outset that force majeure is a concept that has different implications in civil law and common law systems. As set out in Gide Loyrette Nouel's recent briefing on the implications of force majeure and hardship in PRC law[6], force majeure has a statutory character set out in the civil code with an established understanding as to its definition, when it might apply and the means of bringing a claim for relief. The concept of force majeure was imported into English law from civil law systems and so, unlike the doctrine of frustration of contract for example, is not a term of art in English law[7].

Force majeure is a term that can be drafted expressly into a contract therefore and, failing that, may not apply at all[8]. This contrasts notably with other European legal systems[9] and also some hybrid legal systems, such as the United States. Many counterparties entering into English law contracts may in fact have a narrower concept in mind restricted only to an "Act of God" or natural cause without human intervention, whereas English contracts very often will contain governmental or other intervening events[10].

THE CRITERIA UNDER ENGLISH LAW

An English lawyer understands force majeure to describe a term drafted into a contract by which a party is entitled to cancel the contract or is excused some element of performance upon the occurrence of specified events beyond the party's control.

Force majeure clauses take many forms as drafted but the case law generally suggests that three elements must be present:

1. The event giving rise to the force majeure must be completely outside the parties' control[11];

2. That event should make performance of the contract impossible by the party seeking relief[12]; and

3. There should be a direct causal link between the event and the impossibility of performance[13], such that the event must be the sole effective cause of a party's inability to perform[14].

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[6] https://www.gide.com/fr/actualites/the-impact-of-the-new-coronavirus-covid-19-on-contractual-obligations-force-majeure-or?destination=views/news/search%3Ffield_news_term_type%255B0%255D%3D15%26field_news_term_type%255B1%255D%3D14%26field_news_date_publish%255Bdate%255D%3D%26field_news_date_publish_1%255Bdate%255D%3D%26search_api_views_fulltext%3D

[7] *Hackney Borough Council v Doré* [1922] 1 K.B. 431, 437.

[8] A clause stating "the usual force majeure clauses to apply" has been held void for uncertainty (*Fairclough, Dodd & Jones Ltd v J.H. Vantol Ltd* [1957] 1 W.L.R. 210, 230-231)

[9] Article 1218 of the French Civil Code defines "force majeure" expressly, for example.

[10] *Matsoukis v Priestman & Co.* [1915] 1 K.B. 681. In *Lebeaupin v Crispin & Co.* [1920] 2 K.B. 714, 720, Macardie J. held that force majeure was a wide concept, and could cover war, any direct legislative or administrative interference, strikes or accidental breakdown of machinery.

[11] An event of force majeure will not therefore be construed to cover events brought about by a party's negligence or wilful default (*Sonat Offshore SA v Amerada Hess Developments Ltd* [1988] 1 Lloyd's Rep. 323, 327)

[12] *Mamidoil-Jetoil Greek Petroleum Co SA v Okta Crude Oil Refinery AD* [2003] 1 Lloyd's Rep 1.

[13] *Hoecheong Products Co Ltd v Cargill Hong Kong Ltd* [1995] 1 WLR 4040, 409.

[14] *Seadrill Ghana Operations Ltd v Tullow Ghana Ltd* [2018] EWHC 1640

The burden of proof is on the party claiming the relief[15], who must prove the facts that bring the event within the specific force majeure clause and show that non-performance is due to the event.

In contrast to other legal systems, there is no expectation that the event of force majeure should be unforeseeable. A court will not limit the ordinary meaning of the words in the force majeure clause to events or facts that were not in existence or were not predictable at the time that the contract was entered into[16].

In order to understand whether the Covid-19 virus could trigger force majeure under an LNG Sale and Purchase Agreement ("SPA") therefore, it is important both to look at the type of force majeure clause in the LNG SPA, and to consider the operational aspects of the particular LNG commercial transaction.

LOOKING AT THE SPA[17]

What are the grounds under which force majeure can be claimed?

The LNG SPA will typically contain a non-exhaustive list of events or circumstances that could be force majeure. It will also contain a list of the type of events and circumstances that a party cannot claim as force majeure[18].

The English court or arbitral tribunal will seek to determine the objective meaning of the contractual language used by the parties. In doing so, they will consider not only the wording of the force majeure clause but will also consider the contract as a whole. Force majeure clauses will be interpreted by reference to the express words used and not by the parties' general intention, so an English court or tribunal will be considering how all express terms of the contract provide meaning to each other rather than aiming to infer terms into the contract[19]. An LNG SPA will be viewed as a contract between two sophisticated commercial parties in a long-established, albeit fast changing, market. It will therefore be difficult to adduce external evidence of what has become "market" over a short recent period or in the period since the parties entered into the LNG SPA, and recent English decisions have been reluctant to give such evidence weight[20].

By way of illustration, therefore, even if "epidemic" or "pandemic" are included events for force majeure, or the indirect effect is captured, e.g. "shortage of labour" or "lack of raw materials", the party relying on them will still need to show both that the express contract exclusions do not act to exclude such a ground and that the other requirements of the force majeure clause are satisfied. If "market factors" or "economic conditions" are excluded events and one of these is in fact the principal effect of the "epidemic", then the fact that "epidemic" is included in the list of potential force majeure events will not automatically mean that force majeure is triggered.

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15 *Mamidoil-Jetoil,* supra.

16 *Navrom v Callitsis Ship Management SA* [1988] 2 Lloyd's Rep. 416, 420

17 We have referred to the LNG SPA throughout but this will of course also apply to LNG charterparties. The LNG shipping market has seen freight costs fall very significantly in parallel with the coronavirus crisis, which may exacerbate this further.

18 See note 10 above. Not every ground that has ever been accepted by an English court will still be relevant, e.g. "acts of the Queen's enemies", whilst others previously disallowed have become commonplace, e.g. "adverse weather conditions". Although there are some considerations to be made in terms of what might have been meant in a particular industry, the court or arbitral tribunal will generally give an ordinary English meaning to a word.

19 *Coastal (Bermuda) Petroleum Ltd. V VTT Vulcan Petroleum SA (No 2) (The Maritime Star)* [1996] 2 Lloyd's Rep 383

20 *TAQA Bratani Ltd & Others v RockRose UKCS8 LLC* [2020] EWHC 58 (Comm).

Similarly, for example, a party seeking to interpret a "quarantine restrictions" ground to cover the temporary absence of receiving terminal staff may be stymied by an interpretative clause that provides that parties should act to a certain standard, e.g. a "reasonable and prudent operator", which might dictate that an LNG receiving terminal seeking to rely on that interpretation would be expected to have disaster planning and staff replacement schemes in place.

The event itself, therefore, is intimately linked to its effect and whether mitigation is possible.

What is the standard to be applied?

The requirement under English law is that the party claiming force majeure must show that the circumstances were beyond its reasonable control. The concept of "being 'beyond [a corporate person's] control'" sets a comparatively high hurdle since corporations usually do have a significant measure of control over their own business.

There are some cases, however where a force majeure clause requires that the event be unforeseen. Although this may be a requirement of force majeure itself in some jurisdictions, there is no strict requirement under English law that the relevant circumstances invoking force majeure were unforeseeable in the absence of an express or implied term in the contract[21]. This may be a difference between English law LNG contracts and those using another governing law and it is certainly a difference with the PRC law position. Such a clause will not simplify matters in the case of the coronavirus, in our view, as arguments can be made that the actual event affecting the contract was foreseeable. For example, many of the emergency power laws that have been used were on the statute books at the time the LNG SPAs or charter parties were entered into and their invocation was therefore not unforeseen.

Where force majeure is qualified

Some force majeure clauses qualify performance as to whether it has been hindered, impaired or delayed due to the force majeure event. It is important to note at the outset that, if force majeure wording is unqualified (e.g. "subject to force majeure" or "except for force majeure"), then performance must be prevented and not merely hindered, delayed or its performance made more onerous[22].

Where the force majeure clause is such that the event must "prevent" a party's performance of its obligations, then that party must show that performance is legally or physically impossible, not just difficult or unprofitable.[23] In cases further down the chain of trades of an LNG cargo therefore, a party will be unlikely to be able to claim that it could not perform because it was physically impossible to reach an LNG regasification terminal so the qualification of this standard will become more important.

The terms "hinder", "impair" and "delay" are of wider scope, and may offer a window of opportunity for LNG carriers being asked to divert cargoes. Delays for carriers already on the water are dealt with in delay and demurrage clauses and, where the event is known before the LNG carrier has left port, in provisions for alternative delivery. There may therefore be arguments over the correct allocation of the costs of diversions or re-scheduled cargoes necessitated by a coronavirus event but force majeure will not allow parties to be excused for their convenience of obligations that it is still possible to perform, purely because the contract

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[21] *Navrom v Callitsis Ship Management SA* [1987] 2 Lloyd's Rep 267, 281, 282

[22] *Navrom* supra

[23] *Tennants (Lancashire) Ltd v G.S. Wilson & Co. Ltd* [1917] AC 495

has become "economically more burdensome".[24] An event that simply increases the cost of performing the contract alone has been held to be insufficient to show that performance is hindered with the claimant being held to a higher standard[25]. It should be noted that LNG SPAs will often contain a mechanism for the allocation of such incremental costs of making a delivery.

Some LNG SPAs preclude a claim of force majeure for the unavailability of facilities more directly by providing that such an event can only be claimed if the facilities are damaged or not capable of being operated due to the relevant event.

All of this said, English law does not contemplate that a party merely proves the event and does nothing. It is necessary to show that the claiming party has endeavoured to overcome or to mitigate the force majeure event, using reasonable diligence.[26] If, as most LNG SPAs do, the contract contains explicit obligations on the parties to take steps to mitigate the effect of a force majeure event, then a demonstration of compliance by the affected party will be a necessity if reliance on the force majeure clause is to be effective. Even without express contractual provision, such a duty to mitigate may be implied by an English court or tribunal anyway.[27] As is discussed in compliance strategies, this will all need to be carefully documented.

Mitigation - the particular case of LNG

The LNG market, and particularly the long-term supply market, works on the basis of annually planned delivery programmes. The LNG SPA sets out a mechanism whereby these are scheduled and adjusted through the year. A point that might not be obvious to those outside the industry is therefore that, in many cases, it will not be possible to determine if an event of force majeure has actually happened until the end of that annual programme as it may be possible to deliver the cargo later, or to some other place, such that the annual contract quantity is met.

Where there is a cargo already on the water, or in respect of future cargoes that the parties expect will be affected, the LNG SPA will often contain detailed diversion, alternative delivery or re-scheduling provisions. These may provide for specific incremental costs and cargo prices and may be firm or be on a reasonable endeavours basis. An LNG SPA may contain limitations on the period or the quantities of LNG in respect of which an affected facility can continue to claim force majeure relief where the contract contains optionality as to delivery locations.

The key point is that these terms will be determinative as to how (and possibly whether) a party has been affected by an event of force majeure and as to the level of mitigation required and its cost to the parties.

Where LNG volumes are required to be taken at a later date (or require a buyer to use reasonable endeavours to take such volumes at a later date) then this will have an impact on the position as those cargoes may be delivered and so restore the overall quantity delivered to the contracted quantity or, indeed, they may fail for unrelated reasons that create a different liability. Restoration quantities are taken at the market price at the time of actual delivery, which may be either a higher or a lower price than would have applied at the time of the force majeure event but this is contractually pre-agreed. This is part of the economic bargain that the parties struck on signing.

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[24] *Thames Valley Power Ltd. V Total Gas & Power Ltd* [2005] EWHC 2208, [50]

[25] *Ibid. Lord Loreburn said: "To place a merchant in the position of being unable to deliver unless he dislocates his business and breaks his contracts in order to fulfil one surely hinders delivery."*

[26] *Seadrill Ghana Operations Ltd v Tullow Ghana Ltd* supra

[27] Ibid.

What are the effects of an operating force majeure clause?

The effects of a force majeure clause will depend heavily on the remedies provided for in the contract but, as a basic position, an applicable force majeure event will usually suspend the affected party's obligations and remove their liability for any breach caused by the event. Importantly, the obligations under the contract do not go away and once the event is over the affected obligations are re-activated. Some contracts may require regular reporting and consultation once the event is ongoing, evidence of mitigation and estimated timings for dealing with the particular event of force majeure.

As discussed above, some LNG SPAs do not contain provisions for the obligatory re-scheduling of cargoes and, where this was on a reasonable endeavours basis and cannot be carried out, those volumes may simply be removed from the contract quantity. That may be an acceptable outcome for the seller when prices are high and it is free to market those volumes elsewhere. It would clearly be less attractive in the current conditions of oversupply and low prices. There may also be buyers who genuinely cannot take a cargo and who will suffer a shortfall in that situation.

The event of force majeure can have longer lasting effects if the parties have agreed to include the right for either or both parties to terminate the contract if the event persists for a defined period of time.

All of these provisions will have strict timings, deadlines and notice periods that must be complied with and so, with a mind to keep the best options open, every counterparty should look to the compliance tracking of these conditions for bringing a valid claim, exercising mitigation or seeking remedy.

What formal conditions precedent might be needed to seek force majeure relief?

In many contracts, there are limited formalities around bringing a force majeure claim. A party will be required to serve a notice on the other party.

In most contracts, however, this must be done within a limited time period, failing which relief will not be available. It is rarer in LNG SPAs than in other contracts, but some parties have used a certification provision in force majeure provisions (e.g. outage at a production facility) to require a higher standard of evidential support to the initial claim. It remains to be seen if any such provisions survive or are relevant to the grounds claimed in LNG SPAs with China.

The China Council for the Promotion of International Trade is currently issuing, and apparently in large quantity, force majeure certificates to help Chinese companies in dealing with disputes with foreign trading partners arising from the epidemic control measures. Without an express provision requiring it, an English court or tribunal is unlikely to give such a certificate any particular standing. The underlying grounds of causation will be looked at in the usual way. It is an open question as to what weight, and on what grounds the Supreme People's Court might allow it to influence the enforcement of a successful foreign arbitral award. To date, however, the SPC has repeatedly confirmed that a conflict with Chinese laws or regulations is not sufficient in itself to trigger a breach of the public policy ground under the New York Convention for doing so[28]. It may therefore be the case that such certificates are of limited or no effect in the LNG market.

[28] This was found to be the case even where there was evidence of a breach of the fundamental principle of fairness *GRD Minproc v. Shanghai Flyingwheel* (2009), SPC, [2009] 民四他字第 48 号 (SPC) & [2008] 沪高民四 (商) 他字第 2 号 (Shanghai HPC), 18 June 2009

What other clauses might the parties look to?

It is possible that the parties may have drafted a hardship clause into their LNG SPA, although this would be rare in a recent LNG contract. While a force majeure clause makes the performance of a contractual obligation impossible for period of time, a hardship clause is generally drafted to cover the situation where the contractual equilibrium has been so changed that the affected party believes performance of the contract to have become economic. Although this concept exists in PRC law[29], an English law contract might only require the parties to talk about potential amendments to their transaction terms, rather than impose a hard remedy. Such clauses mandating that the parties meet to discuss the effect of such events were a feature before the early 2000s and had wider application, even to price.

Force majeure should also be distinguished from the English law doctrine of frustration, which requires a party to prove that the performance of a contract has become so radically different from that which they intended when they entered into the agreement, that the contract cannot be performed at all. Frustration therefore does not envisage suspension of the contract but setting it aside completely. This obviously has a high standard to be met in proving a claim and is unlikely to be the basis of any successful claim related to the occurrence of the Covid-19 virus.

Other clauses that might be relied upon will generally result in termination of the Agreement and so may be difficult to prove at present, such as:

Illegality - there is sometimes a provision that provides that an Agreement will terminate if it becomes impossible for one party to perform it, e.g. if continuous quarantine that had the effect of preventing key personnel from accessing an LNG receiving terminal were to be mandated by a regulatory authority. This will operate in tandem with the severance clause so that the term incapable of performance will be severed, and the parties are obliged to perform the remainder. Again, where a contract is to be performed by parties to a certain standard and they are obliged to mitigate, this would seem to be a hard case to make.

Termination - there is often a ground in an LNG SPA allowing for termination when there is a prolonged event of force majeure. These generally have quite a high standard and include a period of at least six months. It remains to be seen whether the development of this particular outbreak could lead to such clauses invoked but it would seem unlikely that there would be impossibility of performance for such a long time, particularly as LNG receiving terminals are not closed at the time of writing.

Compliance strategies

The one constant arising from the Covid-19 outbreak is that it is an evolving situation. The full consequences cannot yet be assessed and, where an LNG SPA is on an annual programme with rights to receive or deliver cargoes later in the year, the effects are also not yet readily discernible from a legal standpoint.

Parties therefore need to seek legal advice on taking definitive action under the contract, whether that be serving notices and observing time periods for performance or whether that be declaring force majeure in the first place. The consequences of a wrongful assertion of force majeure could be as severe as bringing about liability, or even termination, through an anticipatory breach of contract. Equally, a party might lose the ability to bring a claim if it is not brought within the prescribed time period.

[29] See Gide PRC briefing, note 6 above.

As set out above, the specific event that triggers force majeure might not reveal itself until later in the annual delivery programme or it may be a rolling series of events leading to multiple claims. There will need to be close coordination between operations and compliance teams to ensure the preservation of claims and clear correspondence on the one hand, and a pragmatic approach to mitigation and contract management on the other.

The parties should therefore keep careful records to record and protect their position in terms of the LNG SPA. They should also look to ensure that the provisions of related documentation, such as credit support, are observed to not create liability.

A full legal and commercial assessment needs to be made for contract management as, in some cases, there will be an opportunity for negotiation (or re-negotiation) that may have as much to do with wider market conditions in the LNG market as it does with Covid-19.

What is clear at this stage is that the outbreak has already affected the LNG trade.

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