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COVID-19 AND OPERATIONAL AND SUPPLY CHAIN DISRUPTIONS: NAVIGATING THE LEGAL RISK

The IHS Markit Malaysia Manufacturing Purchasing Managers' Index – a performance indicator of the manufacturing sector – dropped to 48.4 in March 2020 from 48.5 in February 2020, reflecting a decline in the performance of Malaysia's manufacturing sector.[1] The COVID-19 global pandemic has placed companies in the manufacturing industry in a precarious position, with government restrictions causing disruptions to operations and the supply chain ecosystem. In this article, we talk about how to navigate the legal risk arising from such disruptions.

Operational and Supply Chain Disruptions

In compliance with the Movement Control Order (“**MCO**”) enforced by the Malaysian Government (“**Government**”), many companies – unless they are manufacturers of ‘critical products’ and have obtained approval by the Government to continue its operations – have had to temporarily shut down its facilities and halt its operations.

Additionally, manufacturers relying on input from different countries that are affected by its own COVID-19 restrictions – lockdowns, movement controls, etc. – may find their supply chain obstructed if they do not already have an adequate business continuity plan in motion.

In the domestic context, manufacturers of critical products which are allowed to operate during the MCO period may also suffer supply chain disruptions from local suppliers, if such suppliers fall between the cracks and have not been approved by the Government to operate during the MCO period.

Navigating the Legal Risk – Review Your Contracts

Whether production stoppages are due to government restrictions on companies' own operations or due to the fact that manufacturers cannot get the necessary input from its suppliers, these disruptions may expose companies to the risk of possible legal liability(ies) if they fail to fulfil their obligations under their contracts. To navigate such risk, contracts should be carefully reviewed to identify the parties' legal rights and remedies in these situations. Here are a few things to look out for:

a) **Governing Law of Contract**

It is important to firstly ascertain the governing law of your contract, as it will form the starting point of exploring the legal recourse available to you. This article is written on the assumption that contracts are governed by Malaysian laws.

b) **Force Majeure**

Force majeure is usually defined as the occurrence of events beyond the parties' control which were unforeseeable at the time the contract was entered into. A force majeure clause acts to limit the liability of the party relying on it. The effect of a force majeure clause on the parties' obligations depends entirely on the wordings and construction of the clause. For example, a force majeure clause may allow the affected party to be excused from the performance of its obligations temporarily for the period that the force majeure event is preventing, hindering or delaying such performance and it may also include a right to terminate the contract.

Whether you or the other contracting party are seeking to rely on the defence of force majeure as a result of these disruptions, the following needs to be considered:

- The defence of force majeure is only available if a force majeure clause is expressly written into the contract. Thus, the first step is to determine whether such clause exists in the contract.
- A force majeure clause usually describes the events which will be considered as force majeure events. The event affecting the party's performance of its contractual obligations needs to fall within one of the events described. For example, it may fall under the event of 'pandemic', 'outbreak of disease', or 'acts of government'.
- The party's performance of its contractual obligations must be affected by the force majeure event. In this regard, it is imperative that the reason for non-performance be clearly identified so that a direct connection to a force majeure event can be established.
- Some force majeure clauses require that the party intending to rely on the force majeure clause to give notice of such force majeure event and to satisfy other requirements before it can be relied upon e.g. to take reasonable efforts to mitigate the consequences of the force majeure event.

As force majeure clauses vary from contract to contract, a careful analysis of the force majeure clause in your contract would reveal whether such clause encompasses the operational and supply chain disruptions resulting from the COVID-19 outbreak, the impact of such clause on the party's contractual obligations, and the requirements to rely on such clause.

c) ***Frustration of Contract***

In the absence of a force majeure clause, parties may be able to rely on the doctrine of frustration provided under Section 57(2) of the Contracts Act 1950 – where an unforeseeable event renders the performance of a contract legally or physically impossible (“**frustrating event**”), the contract is deemed to be frustrated and automatically void from the point of occurrence of the frustrating event onwards. This means that after the happening of the frustrating event, parties to the contract are no longer tied to their future obligations under the contract but only to its obligations before the frustrating event occurred.

It is important to note that the frustrating event must not merely make the obligations more onerous or expensive to perform.[2] It has to go beyond inconvenience, however great it is, and render the performance of the contract ‘radically different’ from what was initially agreed upon.[3] In the manufacturing context, you have to be able to prove that your obligations under the contract have become impossible due to the supply chain or operational disruptions caused by the government restrictions.

d) ***Termination Clause***

One should also consider looking at the termination clause in the contracts to determine the circumstances under which parties are allowed to terminate a contract and whether any of these circumstances have been or could possibly be triggered. Parties should also look out for any provisions specifying the consequences of termination – for example, the return or forfeiture of any payment made under the contract. However, for commercial reasons, the contracting parties may not want to permanently put an end to the business relationship, in which case parties may decide to renegotiate the terms of the contract.

e) ***Extension of Time Provisions***

The contract should also be reviewed to see if there are provisions which provide for an extension of time which may allow the parties some time to overcome any supply disruptions and fulfil its obligations on time.

f) ***Amendment or Variation of Contracts***

If the contract provides for the option of varying and amending the terms of the contract, then parties may agree to renegotiate the terms of the contract to be more practicable. For example, renegotiating the order quantity and payment terms or any other obligations which are affected by the disruptions. Such provision usually requires the variation to be made in writing and signed by all parties. Even if no such requirement is

specified, it is prudent for parties to ensure that the amendments be put in writing to prevent any future dispute regarding the varied terms.

Conclusion

With the uncertainty of possible further extension of the MCO period looming over businesses, and with many jurisdictions worldwide still under lockdown due to the COVID-19 outbreak, it is important that businesses – which are, or may be, impacted by disruptions to their operations and supply chain ecosystem – are aware of their rights and liabilities under their contracts.

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1. IHS Markit, News Release, IHS Markit Malaysia Manufacturing PMI
<<https://www.markiteconomics.com/Public/Home/PressRelease/bccf3042d0be4fdeb18f4b45d3221204>>
accessed on 9 April 2020
 2. Yee Seng Plantations Sdn Bhd v Kerajaan Negeri Terengganu & Ors [2000] 3 CLJ 666
 3. APT Associates Sdn Bhd v Adnan Ishak & Ors [2016] 4 CLJ 277

Important Information

Azmi & Associates has set up the Azmilaw Task Force to look into all issues arising from COVID-19 and MCO. Clients are welcome to contact their usual Partner who will bring their issues to the Azmilaw Task Force for our further action.

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We hope the above discussion is of assistance to you and your company. If your company's operations or contractual obligations are affected by the COVID-19 outbreak, we are available to assist you on any queries you may have.

Corporate Communication
Azmi & Associates
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