



Force Majeure in supply contracts

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Introduction

Suddenly everyone's talking about force majeure. What is it? And why, in practical terms, does it matter?

Imagine you're a buyer for a major pharmaceutical retailer and have a big contract for the supply of paracetamol from a generic pharma company in India. COVID-19 comes along, China locks down. Suddenly supplies to India of the active ingredient, from Chinese factories, dry up.

The Indian supplier tells you it cannot meet its contractual commitment due to the Chinese lock-down. It claims not to be liable for its failure to supply since what's stopping it is a force majeure event.

There it is, the supplier claiming force majeure. However, the concept can benefit buyers too. Imagine you are a buyer for a big hotel chain, with a fixed long-term commitment to buy food service supplies.

With the lock-down, the last thing the hotels need is more consumables. Your boss reminds you there's a force majeure clause in the contract and tells you to notify force majeure to stop all deliveries.

But what is force majeure? Can the Indian supplier pull this on you? What's going on? (Can it genuinely not supply? Or is it trying to pull out of your contract to sell its stock at higher prices elsewhere?) Can you say "no" to foodservice deliveries?

What is force majeure?

"Force majeure" means different things in different contexts. In general terms, it refers to an event which:

- (i) prevents a contractual party from keeping its promises
- (ii) was unforeseeable (a bolt from the blue) and
- (iii) the affected party cannot get round in some way.

Force majeure definitions often include the phrase "Acts of God", which has no precise meaning either – even to a theologian much less a lawyer.

Whether it's the Indian paracetamol supplier or your hotel business, there is potentially huge damages liability involved if contractual performance doesn't happen. Declaring force majeure might be the perfect get-out-of-jail card.

Only, however, if there is a legal basis to do so.

How does force majeure apply?

To generalise for the sake of a starting point, the world divides between followers of the British common law tradition of judge-made law and followers of the continental tradition of codified civil law. The world is united in the idea that courts have to treat people fairly, but "fair" can mean different things. Say we're enforcing a clear contractual right, but with results which, in the particular case, are harsh on the defendant. To a French court it might seem "fair" to over-ride the contract to avoid the harsh result; to an English court that might seem like unfairly taking sides, and that the "fair" thing is to enforce the contract impartially, to the letter, whatever the consequence; while to a Chinese court, fairness might mean impartially enforcing the people's will as uniquely determined by the Communist Party.

That generalisation has enough truth for it to be no surprise that “force majeure” is a French expression, not an English one. It traces its descent back to the ancient Roman law which the continental codified tradition is based on. In much of Europe, and in certain other countries (notably including China), “force majeure” is baked into the basic notion of judicial fairness, because it’s baked into their legal codes. Any party to a contract can, in those jurisdictions, plead force majeure as a defence in law regardless of whether their contract even mentions FM.

But generalisations only go so far. English law has its own force-majeure-lite. It’s called something different: it’s the long-established common law doctrine of “frustration”. More follows below.

The result, all over the world, is that there are two distinct ways in which force majeure (or something similar) can affect a contractual relationship: either under the terms of that contract, or under the governing laws. The contract might have a force majeure clause, in which case the courts will (subject to any supervening legal rules, such as consumer protection laws or competition laws) enforce it; or the laws of the land – of frustration in the common law tradition (notably in the British Isles, the old Commonwealth countries and the USA,) of force majeure in the codified tradition – might take effect. Or, indeed, both might be in play in which case the court has to decide which takes precedence.

Whichever the legal tradition, parties are free to negotiate “force majeure” clauses into their contracts and (other things being equal) the courts will enforce them. So what do these clauses say and how do they work?

What’s the process, with force majeure clauses?

To do its job, a force majeure clause needs to answer three key questions:

- (1) **What does force majeure mean here?** In a contract, “force majeure” means whatever the parties want it to mean. Some clauses are tightly drawn, others much looser. A few are so loose as to allow the supplier to drive a coach through any awkward situation. Buyers beware! A good definition is a key part of the negotiation.
- (2) **How is the clause triggered?** Most clauses, and all well-drafted ones, will have a notice mechanism, such that the party claiming force majeure must promptly notify the other party that the FM circumstance has arisen, what it consists of and what effect it is having on contract performance. Normally that notice will have to comply with a “notices” clause elsewhere in the contract. Many disputes about FM will, in practice, turn not on force majeure as such but on whether the notice was correctly served. Was it issued to the right address? If sent by email, is that effective notice under the “notices” clause?
- (3) **What is the consequence of FM?** Lastly, so what? What does declaring FM actually achieve? Again, it’s down to the contract wording to say, but normally FM will relieve the affected party from liability for delays while the FM subsists, and sometimes it allows either party to bring the contract to an end if the FM goes on too long.

How should buyers approach force majeure clauses?

The first consideration for buyers negotiating a procurement arrangement is whether there should be an FM clause in the contract at all.

Start by thinking about why the clause is there. It is NOT there to make a moral judgement that a party should only bear risk for its fault. Force majeure only arises in instances which are neither party's fault – so these are risks which fall on a morally innocent party either way. The only good reason for agreeing force majeure is if one party would walk away from the deal rather than incur those risks. Why would that happen? Only, really, for two possible reasons: one is that it is a seller's market, such that if you won't agree to force majeure, the next buyer in the queue will; and the other is if force majeure risks are so huge as to be fatal to that party's business.

So look carefully at that force majeure definition and ask whether it needs to be so wide, or there at all. Isn't the supplier insured for part, at least, of those risks?

Are some of the defined FM circumstances really outside the supplier's control (labour disputes?) or expectation (weather?).

Look at how much you are giving away by agreeing to an FM provision. If certain risks are genuinely so big as to be a life-or-death threat to the supplier, the downside to the buyer from accepting an FM clause may be somewhat academic. There's no point having the theoretical right to sue a supplier if the effect would only be to bankrupt them. And there's no point resisting an FM clause if the claims that you would forgo would in practice be for indirect losses, such as loss of profit, which are already foregone under the supplier's "Limitation of Liability" clause elsewhere in the contract.

If you do accept an FM clause, then study the wording carefully and make sure all three elements work correctly. They (definition of FM, notice requirement, consequence of FM) need to be crystal clear, practical, and no wider than necessary.

Far too many FM clauses get accepted just because they are usual (part of the custom and practice of the industry – a lame excuse) or (even worse) because the FM clause is part of the "boring" boilerplate content towards the back of the contract and the buyer couldn't be bothered to engage with it. Not acceptable!

Finally, if you do give the nod to an FM clause proposed by the supplier, think about making it work for your business as well. Is it worded in reciprocal terms, to protect both parties? It should be! Even if it is, is FM defined in a way which protects the buyer business?

At the start of this article we touched on a hotel chain which, thanks to the lock-down, suddenly doesn't need more supplies. Under most FM definitions this would NOT count as FM. Why? Because there's nothing about the lock-down which inevitably stops the buyer from accepting deliveries and paying for them. The buyer's problem is that it no longer wants the deliveries, which is a different matter entirely.

That's all if there's a force majeure clause in play. But:

What if there's no force majeure clause at all?

As we've seen, there is no such thing as force majeure in English law. There is, however, the doctrine of "frustration". This has much narrower application but a more devastating effect. It applies only if a court can be convinced that there has been such a change from the circumstances originally envisaged by the parties that the contract, as a whole, is simply incapable of being carried out. But if so, the whole contract is unenforceable. So frustration is a much stiffer mountain to climb than a well-drafted FM clause, and one probably with a few unmapped crevasses along the way, but if they get to the summit the party claiming frustration is not just protected from liability for delays, but can see the contract torn up altogether.

An English court will also, on public policy grounds, decline to enforce an illegal contract requirement. The same rule is likely to apply in other jurisdictions too. So when FM circumstances arise which consist of legally enforceable export bans or the like, the party seeking protection may well find it that way, instead of (or as well as) under an FM clause.

And always look at the big picture. Sometimes the shelter which the affected party is looking for is right there in the main contract promises. If you are contractually obliged to deliver a consignment of paracetamol by a set date, you'll need an FM clause to protect you if something big gets in the way. But if you are contractually obliged to "use all reasonable efforts" to deliver that consignment, you don't need FM or anything else. You were home and dry before you even started looking.

So is force majeure such a big deal, due to the pandemic?

All round the world businesses are fighting for their very survival, and playing pass-the-parcel with huge losses and write-downs. You bet they'll take advantage of an FM clause if they can.

Think strategically. Where in your supply chains are the big stresses, the main risks? How might a supplier try to save itself from liability to you? Looking at how the FM clause plays out, in detail, in the particular circumstances, do they have a case and what could you do about it? Better to know your ground before the supplier plays the FM card, and have thought about how to react.

Should you even be looking to fight with the supplier? Or should you accept what may be the painful practical reality, of losses being borne where they fall. If so you could turn that dismal truth into a useful initiative to win supply chain loyalty for the future, by pre-emptively announcing to the whole supply chain that as a matter of policy, to look after your suppliers, your company won't be claiming any damages for delays or failures caused by lock-down or COVID-19 causes.

Because one thing's for sure about the radically different world in which we suddenly find ourselves: it's a good time for imaginative lateral thinking!

Author



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