

## INTERNATIONAL TRADE

# FORCE MAJEURE CLAUSES: THEIR ROLE IN SALE CONTRACTS

There have been a number of global events in recent years that have threatened the performance of international sale contracts. Firstly, there was the 2008 financial crisis and global recession. This was followed by a number of natural disasters, including the eruption of the Icelandic volcano Eyjafjallajökull, the Japanese earthquake and tsunami, floods in Australia affecting the export of commodities such as coal and drought in Russia threatening wheat crops. There has also been civil and political unrest in the Middle East and North Africa this year, which has jeopardised the fulfilment of contracts with counterparties in the affected countries. This briefing considers the options open to traders faced with such situations and reviews how they might best protect themselves.

### Frustration of contract

A party faced with an external occurrence or event that may make its performance under a contract impractical, onerous or even impossible might seek to argue that the contract has been frustrated. Under English law, frustration will result in the contract being terminated so that the parties are excused from further performance. However, in order for a contract to be frustrated, the event in question must be unforeseen, it must have occurred without the fault of either party to the contract and it must either make the contract's performance impossible or it must destroy the fundamental purpose of the contract. The contract must also not contain a provision dealing with the supervening event, otherwise there can be no frustration on the basis that the contract has already allocated risk in terms of that occurrence.

It is rare for an argument of frustration of contract to succeed before the English courts. A change in circumstances which means that one of the parties turns out to have made a bad bargain will not be sufficient. Arguments based on a sharp drop in the market, global recession and unavailability of the goods from the original source have all failed in recent years.

For example, in the case of *CTI Group Inc v Transclear SA (The Mary Nour)* [2008] EWCA Civ 856, the sellers of cement consignments sought to argue that the sale contracts were frustrated because their suppliers had let them down as a result of a cartel being operated in the Mexican cement market. The English Court of Appeal held that the seller had taken on the risk of its chosen supplier not making the goods available. The implication was that the seller could have sought to obtain similar goods elsewhere in order to fulfil its contractual

obligations even though this might have been financially burdensome and ultimately unprofitable for them.

### Frustration compared to force majeure

Given the reluctance of the English courts to find that a contract has been frustrated, many international trade contracts incorporate force majeure ("FM") clauses. Force majeure is not an English law concept but it can be applicable to contracts governed by English law where the parties have incorporated an express FM provision in their contract. An FM clause provides that one or both parties can cancel a contract or be excused from either part or complete performance of the contract on the occurrence of a certain specified event or events beyond the parties' control. Sometimes the FM clause will entitle one or both parties to suspend performance or to seek an extension of time for performance. Unlike frustration, therefore, an FM event will not always bring a contract to an end if the FM clause provides otherwise. For example, many GAFTA forms contain force majeure/strikes clauses which allow the seller to serve a notice on buyers setting out that a delay is likely to occur in delivery or shipment of the goods in question and, if necessary, seeking an extension of time. Where the delay in question extends beyond 30 consecutive days, the buyers will then have an option to cancel the delayed portion of the contract.

Another difference between frustration and force majeure is that English law does not prevent a party from relying on an FM clause in relation to an event that existed at the time the contract was concluded (so long as the FM event falls within its terms), whereas frustration will only apply in relation to a supervening event. Furthermore, an event must have been unforeseen in the case of frustration, whereas an FM clause can be relied on even if the party relying on the FM event could reasonably have been expected to take it into account at the time of entering into the contract.

### Drafting an FM clause

A well-drafted FM clause should contain the following:

- > the specific events that will trigger the operation of the clause, together with a general provision designed to cover events that are not expressly listed
- > what the parties are obliged to do in terms of relying on a FM event
- > the consequences of an FM occurrence i.e. defences/remedies available to the parties

### Defining FM events

An FM clause should define the FM events it is intended to cover. Although the FM events will differ according to the type of contract, the commodity being bought and sold and the countries involved, the types of specific event that are normally listed in an FM clause include:

- > act of God (this may cover extreme weather conditions such as floods)
- > war or threat of war, terrorist act, blockade, revolution, riot, civil commotion
- > fire
- > industrial action/strike
- > government action
- > embargo
- > unavailability of goods
- > default of sub-contractors or suppliers
- > loss or breakdown of carrying vessel.

Drafting the list of specific events can be tricky because there is a risk that an important event will be omitted. Often, therefore, a general sweeping-up clause, such as “*any other event or circumstance beyond the parties’ control*” will be incorporated into the FM provision to cover such eventualities. Such a sweeping-up provision will, however, be interpreted within the context of the remainder of the FM clause i.e. it will be interpreted only to cover events of a similar type to those specified in the clause. The FM clause will equally not apply to failures in the performance of obligations undertaken by a party unless it is clear from the words that that is the intention of the parties.

An example of both these issues arose in the *Kriti Rex* [1996] 2 Lloyds Rep 171. The FM clause in that case was in an FOB contract for the sale of bananas and was worded to apply to ... *shipwreck...and any other events beyond the control of the parties which affect the production, sale, shipping, exportation of bananas either to, at or from the place of exportation*”. The buyers in that case failed to load, as was their obligation, because of an engine breakdown suffered by their nominated vessel. The Court decided that an engine breakdown was not a “*shipwreck*” and that the words “*any other events*” did not extend to such a breakdown. Moore-Bick J, (as he then was) went on to say:

*“In general I think it fair to approach such clauses with the presumption that the expression force majeure is likely to be restricted to supervening events which arise without the fault of either party or for which neither of them has undertaken responsibility...”*

Thus, since under the contract concerned the buyers had taken responsibility to load the cargo, the Court found that they could not rely on the FM clause.

However, the result may have been different if the clause had begun with a general definition of FM being, say, “*any event or occurrence or circumstance reasonably beyond the control of the party...*” followed by a recital of the same events as a non-exhaustive list of examples of the sort of events which would be regarded as such events/occurrences/circumstances. Alternatively, the same result can be achieved simply by the addition of the word “*whatsoever*” after the words “*other events*”.

### Reporting an FM event

The FM clause should specify the form of notice that must be served on the counter-party identifying the FM event that is being relied on to activate the clause, as well as where the notice should be served. This should help avoid subsequent disputes as to whether the notice given was adequate and was validly served. The clause should also state that the giving of notice is a condition precedent to reliance on the clause – if that is what the parties wish.

### Effects of FM clause

The parties should specify in the clause what their rights and obligations are on the happening of an FM event. These could be:

- > a right to terminate without liability on either side upon the happening of the FM event and the requisite notice being given, or
- > suspension of performance until the FM event ceases, without liability on the non-performing party in respect of delay and a re-activation of contractual obligations thereafter, or
- > a right for the affected party to seek an extension of time for performance without liability in damages for the delay.

### Relying on an FM clause

It is for the party seeking to rely on the FM clause to prove that the event in question falls within the clause, that the event has prevented or delayed its performance under the contract and (usually, but depending on the wording) that this is beyond its control. The wording of the FM clause is, of course, the starting point. For example, the GAFTA force majeure/strikes clauses referred to above will not automatically excuse a seller from making delivery of the goods just because there has in fact been a strike as per the clause. The seller will still have to prove that he has been prevented from delivering on time as a result of the strike and this will be a factual question dependent on the seller’s circumstances in each case.

It is also important to distinguish between clauses which require an FM event to completely prevent performance and those which will cover an FM event that only hinders or delays performance. Where the clause requires performance to be prevented before a party is excused from its contractual obligations, this means that any risk of delay and its consequences will fall on the party that was expected to perform.

For example, GAFTA contracts no. 100 (CIF terms) and 49 (FOB terms) both contain a widely drafted prohibition clause covering prohibition of export, blockade, hostilities, executive or legislative act done by or on behalf of a government of the country of origin of the goods or of the territory where the port of shipment is situated. In the case of prohibition of export preventing fulfilment of a contract, the clauses provide for the contract or any unfulfilled part of it to be cancelled. However, it is open to the parties to standard form contracts containing similar provisions to extend them so that they cover not only prohibitions of export but also export restrictions.

Such provisions became particularly relevant in 2010 as a result of the temporary Russian wheat export ban. Affected contracting parties were advised to check their sale contracts

carefully to establish whether the permissible origin of the goods contracted for was limited by the terms of the contract or whether the buyers could require the sellers to provide goods of a different origin. As a general rule, pre-shipment obstacles will not affect delivery obligations under sale contracts on CIF, CFR and C&F terms unless a particular origin for the goods being supplied has been specified in the contract.

#### FM event or not?

Even where a common FM event is provided for in an FM clause, its scope might be the subject of some debate. The following are just some of the issues that might arise in relation to whether or not a particular event is covered by an FM clause.

**Governmental Act:** the FM clause might list as an FM event governmental acts which make a contractual obligation illegal after the contract has been concluded (known as supervening illegality).

Depending on the wording used, this might be interpreted to cover only domestic governmental acts or it might extend to international initiatives. Prime examples are the recent sanctions against Iran which operate on both a national level i.e. promulgated by individual countries including the UK and USA, as well as on an international level i.e. enacted by the UN and EU. There continues to be some uncertainty as to whether certain transactions are in fact prohibited and, if so, by which set of sanctions. It is vital therefore that appropriately drafted FM clauses (or specific sanctions clauses) are incorporated into international trade contracts to ensure that one or other party is not faced with either breaching its contractual obligations and facing a claim for damages or alternatively finding itself in violation of sanctions and being penalised by the relevant authorities as a result.

**Act of God:** this FM event may raise an issue as to how extreme a natural occurrence or adverse weather has to be before it qualifies as an act of God. Furthermore, whilst the natural event/weather in question might at first glance appear to be covered by the FM event specified, certain indirect consequences of the "act of God" might arguably not be covered by the FM event.

To take an example: the recent Australian floods were severe and caused major disruption to Australia's export trade, particularly its coal exports, due to production being affected in some mines and transport links being interrupted. Mining companies such as Anglo American and Rio Tinto declared force majeure on their Australian coal mines. One company, Japanese power utility Tohoku, was maintaining force majeure on its shipments of thermal coal from Australia even two months after its power plants were affected by the earthquake and tsunami. Nonetheless, some affected coal contracts may not have provided for the supply to originate from particular mines, in which case sellers were faced with an obligation to provide the goods from another source or risk being in default. Furthermore, the product may have been available but its transport and shipment may have been delayed and laycans missed.

Another issue arising in such circumstances is commonly referred to as priority of performance/allocation of capacity. This means that a seller may have enough supplies

notwithstanding a natural disaster or adverse weather but only enough to fulfil some but not all of his contracts. He will then have to apportion what is available and may face claims that one customer was prioritised over another.

Similar issues to the above have arisen in the aftermath of the Japanese earthquake and tsunami, including in respect of Japan's energy and agricultural production. It remains important therefore to have an appropriately worded FM clause to deal with such eventualities.

**War/riot/revolution/civil commotion:** recent unrest in the Middle East and North Africa has highlighted this common FM event. A number of issues arose under some sale contracts, including difficulties in making payment under the contracts as a result of a disruption to communications affecting the local banking systems. This meant that it was not always possible to present documents under letters of credit that involved banks based in a country affected by rioting or other civil commotion before the credit expired. Interestingly, after the eruption of the Icelandic volcano, the ICC issued a statement to the effect that the disruption to delivery of documents due to the shut-down of airspace over much of Western Europe "*is not an event which is covered by the force majeure rules of UCP600 (Article 36). ...the Banks are still open for business; it is the documents that are being delayed in transit to them.*"

Other issues which have arisen as a result of events in the Middle East and North Africa are delays in shipments from affected ports and difficulties in obtaining relevant import and export licences. For example, as a general rule, a CIF seller must perform even if that requires him to ship from an alternative port than the one he intended to ship from. However, it is possible for a contractual term to modify that position so that if shipment from a specified port is prevented by an FM event, the seller is excused from performing

#### Material adverse change clauses

There are also other provisions which are similar to FM clauses and which can sometimes be found in commercial contracts. One example is a material adverse change clause.

These are most frequently used in financial transactions (mergers and acquisitions, bond issues) and give the buyer or bidder the right to walk away from a transaction following material and adverse business or economic developments. However many oil majors (BP, Exxonmobil, Shell) have a similar provision in their general terms and conditions to cover situations where laws change and/or governmental restrictions are imposed and these will have a material adverse economic effect on the sellers. In those circumstances, the sellers are given the option to request renegotiation of the price or other relevant terms of the agreement. If the buyers do not agree to the sellers' proposals, then either party may terminate the agreement after the specified notice period.

#### ICC Force Majeure and Hardship clauses 2003

In addition to their own FM clause, the ICC have produced a hardship clause that can be incorporated into a contract to provide for the introduction of export restrictions. The clause comes into play where continued performance by a party under the contract becomes "*excessively onerous due to an event beyond its reasonable control which it could not reasonably*

have been expected to take into account at the time of the conclusion of the contract". The parties are, however, obliged to negotiate alternative contractual terms which reasonably allow for the consequences of the event and they must do so within a reasonable period of time after the clause has been invoked. It is only if they fail to agree such alternative terms that the party relying on the hardship clause can terminate the contract.

### Comment

Given the importance of ensuring that trade contracts contain suitable provisions to deal with force majeure type situations and having regard to the problems that can arise where such provisions are inadequately drafted, best practice dictates that expert legal advice is obtained by parties at the time they are negotiating terms or, where they trade on standard terms, drafting such terms. That said, it is not necessarily to a trader's advantage to have as wide an FM clause as possible. Generally speaking, it will be a seller (particularly in a CIF situation) who will want a wide FM clause and the buyer a narrower clause. This is because generally FM events will impact sourcing, supply and delivery of goods more than acceptance of delivery. Therefore, in an ideal world, traders would have two FM clauses; a wide one and a narrow one, to be deployed depending on whether they are seller or buyer. Commercially, however, the parties are unlikely to be able to employ differently worded clauses to suit the situation, particularly if they are buying and selling on a regular basis and/or in a chain.



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