

What Is Force Majeure

- Acts of God or other extraordinary events, war, labor shutdown; failure of specific sources of supply, which are exclusive
- Potentially termination by sub-supplier (although there is little case law discussing this)
- Purely financial considerations are generally not sufficient, including unprofitability, increased costs, even if operating at a loss
- Power outages may not be enough
- Efforts to mitigate – seller must use all available means to perform
- Burden of proof is on the seller

How To Protect Yourself

- Best approach – through your contracts
- In the absence of a contract the law defines it for you – e.g. UCC: “performance as agreed has been made impracticable ... By the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made.”
- Contract should clearly define the rights of the parties upon force majeure events, including the notice and support required
- If you are the buyer, put in your contract that you have a right to audit, inspect, obtain supporting information and to cover, at the cost of the seller. If you are seller, you can seek alternative sources, the buyer must help in that regard, and pay any incremental costs over what it would have paid you for the parts
- Information is key – keep the lines of communication open and perhaps cover this in your contract
- Review upstream contracts from your customer before issuing downstream contracts so that your rights are at least the same as your customer’s against you

Notice

- UCC: (1) a statement that there will be a delay or non-delivery; and (2) when allocation is required, a statement of the estimated quota to be made available to the buyer
- Contracts: frequently require more

Timing

- UCC requires “seasonable” notice not to exceed 30 days – sooner is better
- Contracts often impose more stringent timing
- Notice may not be obvious on its face
- Law does not require a particular form
- Look for excuses for non-performance, partial performance or delay
- Quick response required – under the law must respond within 30 days maximum
- Contract can impose a shorter time period
- Contract will lapse if no action taken or no response after 30 days

Buyer’s Options on Receipt of Notice

- UCC Options – (1) terminate the unexecuted portion of the contract or (2) agree to take the buyer’s allocation (thereby modifying the contract)
- Contract Option – contract may have other options, timing and/or require other actions

Response to Notice

- Ask for information on nature of event
- Request compliance with contract
- Reserve all rights even if you take only a portion
- Assert refusal to modify contract
- Decide whether will contest force majeure claim

Litigation/Dispute Resolution

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Allocation of Production

- Allocation applies only where part of the seller's capacity is affected. Rarely mentioned in contracts; thus UCC would apply.
- UCC 2-615 provides: *"Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable."*
- Key question: What is fair and reasonable?
- Note: The allocation can include regular customers even if not under contract
- Per UCC 2-616 – the buyer can terminate or agree to modify the contract, but the buyer must respond "seasonably" to the allocation and in any event no later than 30 days
- Little law on this issue

Key Tips – Allocation as a Seller

- Courts favor allocations based on (1) historical levels of purchase, i.e. past sales figures, purchase from the previous year, purchase from the first quarter, etc. or if the past year's purchases do not reflect the needs of the current year, use forecasts, estimates or sales figures and (2) treating customers alike
- Courts disfavor allocations based on (1) profit, i.e. allocating more to the most profitable lines or (2) self-dealing, i.e. diverting allocations to wholly owned subsidiary, or (3) allocating different percentages, i.e. 100% to one customer and 30% to another and (4) allocating so that some customers get 0%
- Some courts look at hardship as a factor
- If production from specific sources have been allocated to a customer in the past, that may be deemed fair

Key Tips – Responding to a Notice of Allocation by a Seller

- Respond timely and no longer than 30 days from notice
- Ask seller to explain the allocation
- Ask seller to explain how it determined your portion vs. other customers
- Ask seller about other plants able to make your product whether that was considered
- Ask about other sources for the products and whether they were explored
- Send notice to your customers if they will be affected

Obtain information on basis – then respond

- Describe, if you can, the hardship to you based on this allocation
- Describe why you believe the allocation is not fair and reasonable this is where the fact finding will help

Disaster Planning Checklist

- Plan before the disaster happens
- Check on other sources of supply in case your supply is affected
- Secure your computer records with backup in another location
- Make sure your insurance covers for disaster, business interruption, and code required updates to your plants and buildings
- Put in your contracts if you can that costs of cover, i.e., to buy substitute goods that are more expensive, and expedited freight, are shared
- Use your disaster planning as a sales tool
- Think about using P.R. to help write any communications to your customers about a disaster event

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