

Resources

Earthquakes, Tsunamis and Force Majeure Clauses—What Do They Mean To Your Business?

May 4, 2011

The recent natural disasters in Japan have resulted in disruption to supply chains for many companies whose products incorporate goods or materials from the impacted areas, including the inability to meet delivery and production schedules, among other things. As a result, many are evaluating their contracts for an often-overlooked (or nonexistent) clause: the force majeure clause.

If your contract contains a force majeure clause, that provision will govern the rights and responsibilities of the parties. However, if your contract does not contain a force majeure clause (or the clause is lacking in some respect), the Uniform Commercial Code's instructions regarding commercial impracticability will apply.

What is commercial impracticability under the UCC?

Under UCC 2-615, "commercial impracticability" is defined as "performance as agreed has been made impracticable by the occurrence of a contingency, the nonoccurrence of which was a basic assumption on which the contract was made."

Is performance excused for a seller if the cost of supplying the contracted goods increases substantially due to natural disasters?

Greatly increased costs to the seller, even if not expected, are generally not sufficient to establish commercial impracticability, and increased costs do not excuse performance under the UCC. Most courts hold that if the seller can perform, even at a substantially higher cost, the seller must so perform. For instance, if the seller's low-cost production facility has been impacted by natural disasters but it has other facilities from which it can manufacture the goods in question (but at a higher cost), the seller generally must perform. This does not mean, and it is unlikely, that a court would require a seller to expend the costs to rebuild a completely destroyed facility.

What if the parties' contract requires that the goods at issue be manufactured exclusively at a specific plant?

If the parties' contract requires that goods be produced from a specific facility or an exclusive source, the destruction of such facility may qualify to excuse performance under UCC 2-615. For the automotive industry, Production Part Approval Process (PPAP) or other validation processes that specify places of production may contribute to the assertion that a source of supply is exclusive.

What type of measures must a seller employ before relying upon UCC 2-615 to excuse performance?

UCC 2-615 will not excuse performance unless the seller has employed "all due measures" to assure itself that its source will not fail. Further, a seller cannot create or contribute to the event that causes the event that makes performance commercially impracticable.

Can a purchaser rely upon UCC 2-615 to excuse performance and avoid buying goods or materials?

Generally speaking, only the obligations of a seller are excused by UCC 2-615. Some cases and comments suggest that a purchaser might have relief, but such cases and comments are not the norm. Additionally, remember to check your written

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contracts, which may provide relief to sellers and buyers.

Dykema's Japan Crisis Task Force is ready to assist companies impacted by the recent natural disasters. Please contact one of the individuals listed below to discuss how we can help you navigate this difficult situation.

Supply Chain Issues/Litigation

Contract Issues

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For more information about Dykema's Automotive Industry Group, please contact **Aleksandra Miziolek** at 313-568-6762, or your Dykema relationship attorney.

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Industries

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