

Resources

Notice of Force Majeure—How to Recognize It and Respond to It

May 25, 2011

In the wake of the Tohoku earthquake and tsunami, some buyers of goods affected by those events have begun to receive notices from their suppliers that the deliveries will be delayed or stopped in whole or in part. These notices are meant to provide the supplier with a legal excuse for its nonperformance and to protect it from liability. Commercial law dictates the content of those notices and starts a clock that buyer's cannot afford to ignore. This alert identifies the notice requirements and explains generally the buyer's options and the timetables that apply.

Floods, earthquakes, tsunamis, droughts, government restrictions (as happened in the 1970s with petroleum) and other phenomena can make the conduct of business impossible or impractical in one respect or another. Most business people know this as "force majeure." In the more modern treatment under the Uniform Commercial Code (the "UCC"), it is called "commercial impracticability." Regardless of what you call it, it invokes some especial rules under the law that provide relief to those affected by the circumstances. The tradeoff for that relief is several other rules that require the affected sellers to treat their customers fairly.

Where a seller's performance is rendered entirely commercially impracticable, the seller's obligations are excused. Where a seller's capacity to perform is only partially affected, the seller must allocate production and deliveries among its customers in a fair and reasonable way. In either case, the UCC requires that the seller give notice to each of its buyers. The notice must contain a statement that there will be delay or non-delivery and, when allocation is required, a statement of the estimated quota to be made available for the buyer.

The notice might not be obvious on its face. Although savvy business people are frequently aware that there's something called a "force majeure notice" or "commercial impracticability notice," nothing in the law requires that the notice bear any particular name or be in any particular form. Whomever receives correspondence for a purchasing organization should be briefed about what to look for and instructed to forward to management or the legal department any correspondence that contains the elements identified above. Buyers should closely scrutinize any notice that purports to give excuses for non-performance, partial performance, or delay to determine whether it is a seller's attempt to rely on a defense of commercial impracticability to avoid performance.

The notice of commercial impracticability must be given "seasonably." Although the UCC provides little guidance about what that means, the primary consideration in the case law as whether notice is "seasonable" seems to be the effect on the buyer. If the buyer is able to do something to mitigate the impact of the seller's delay or nonperformance, the seller should give notice to the buyer while the buyer still has time to take that mitigating action. In any event, it behooves any seller of goods who wants to rely on the commercial impracticability defense to give notice as soon as practicable.

A seller's notice triggers a limited set of options for the buyer and requires that buyer take action within a limited period of time, not to exceed 30 days. Under the UCC, once the buyer receives the notice from the seller, the buyer has two options: (1) terminate the unexecuted portion of the contract or (2) agree to take the buyer's allocation in substitution of the contracted-for quantities.

The buyer must decide quickly what to do. Failure by the buyer to terminate or modify the contract by notice to the seller (within a reasonable time not to exceed 30 days) causes the contract to lapse with respect to any deliveries affected.

The UCC does not define "lapse." It is clear that the obligation of the seller is excused to the extent of the deliveries affected. It is not clear, but possible, that the contract will stay in place and that the seller's obligation to sell (and the buyer's obligation to buy) will come back into existence once the force majeure abates. This can create inconvenient circumstances if the buyer contracts with another supplier for the affected goods. It is possible that the original supplier could reappear and expect the buyer to honor the purchase commitment in the original contract for the unaffected quantities. Where possible, the buyer should reach express agreement with the original supplier about whether, and to what extent, the original supply relationship will resume after commercial impracticability passes.

The UCC does not expressly give the buyer any option other than the two above: Terminate or accept the modified contract with the allocated deliveries. In the absence of an express agreement otherwise by the seller, the buyer's only alternative to the two stated options appears to be to challenge the seller's assertion of commercial impracticability. If the seller's circumstances don't qualify for the relief under the UCC, the seller is not excused and the buyer gets its remedies, which might include damages, specific performance, and other remedies. But challenging the seller's right to relief is probably not an option in the near-term. It will likely take place in negotiations or in court and neither is likely to occur for months or longer.

Beyond the mere preservation of rights, a buyer receiving a notice of commercial impracticability would be well-served to ask for as much information about the nature of the commercial impracticability as possible. This serves many purposes. First, having more information can help the buyer to plan its activities in light of the unavailability of the goods. Second, the information can help the buyer evaluate whether the buyer should contest the seller's claim of excuse from performance. And, for that matter, the lack of response by the seller to reasonable requests for information can also support a buyer assertion that the seller has failed to give adequate notice under the UCC or that the seller has not given the notice "seasonably." Third, if the buyer is also a seller who supplies its own customers in a supply chain, the buyer will have its own obligation to give notice and supply information up that chain. Information from the buyer's seller can be crucial in allowing the buyer to meet its own notice obligations up the chain to its customers.

Note that this alert discusses the parties' rights under the UCC. If the parties' contract treats commercial impracticability differently, the provisions of the parties' contract will likely govern.

Bottom line: A notice from a supplier that there will be delay or non-performance is important, both because it provides information essential to the buyer's business and because it starts a clock for the buyer's action. Buyers need to identify these notices when they come in, understand their options, and act (or elect to not act) with a full understanding of what those acts or omissions do under the UCC.

Dykema has a task force dedicated to assisting companies impacted by the recent natural disasters. If you have any questions regarding this alert or other related issues, please contact the attorneys listed below.

Supply Chain Issues/Litigation

Contract Issues

Laura Baucus	248-203-0796
Sheryl Toby	248-203-0522
Thomas Bishoff	313-568-5341
Janet Stiven	312-627-2153
Marilyn Peters	248-203-0768
Stephen Tupper	249-203-0895

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Regulatory

Labor & Employment

Grant Gilezan 313-568-6789
Martin Jay Galvin 313-568-6912
Paul Laurenza 202-906-8646

Products Litigation

Fred Fresard 248-203-0593

Derek Whitefield 213-457-1777

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

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Attorneys

Grant P. Gilezan
Sheryl L. Toby

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