FORCE MAJEURE IN THE SALE OF GOODS AND COVID-19 LOGISTICS – LEGAL AND COMMERCIAL IMPLICATIONS

Introduction

The objective of this article is to take a look into the legal side of the logistics problems caused by the Covid-19 pandemic. The purpose is not to indulge the legal profession or scholars with a thorough analysis of the intricacies of the subject but to introduce the subject to a more general academic audience within the spirit of *studia generalia*.[1] As libraries have remained closed for one and half months already, it is difficult to collect works of reference. Evidently, this emphasizes the personal nature of the views expressed in the text.

We shall restrict ourselves to the sale of goods only noting however that the performance of a sales contract requires the parties perform or employ services to deliver the goods. Delivery obligations are those that need be examined.

We shall also restrict ourselves to situations where the performance of one of more contractual obligations is virtually impossible under an individual contract and leave aside issues relating to the effects of supervening circumstances to the contractual relationship as a whole. My intention would be to cover the latter situation in a separate article later.

Hierarchy of legal rules applicable to a sales contract

There is a hierarchy of legal rules applicable to a sales contract

1) Mandatory rules (such as sanctions, credit controls etc.)
2) The contract
3) Customs and usages
4) Non-mandatory laws such as the Vienna Convention 1980 (CISG)[2]

Delivery obligations are normally governed by trade terms, which have been harmonised by the International Chamber of Commerce and published since 1936. The latest collection Incoterms® 2020, like its predecessors, become applicable through their incorporation into the sales contract. The incoproration is invariably done through a reference stating the relevant Incoterm, the relevant place (and a point in it) and the name of the colletion or set of the Incoterms. The place and point refer to the place and point where delivery occurs from the seller to the buyer, but with the C-terms CPT, CIP, CFR and CIF it means the place or port to which the seller must contract for carriage. The Incoterms regulate the allocation as between the seller and the buyer of

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[1] *Studia generalia* refers to a series of lectures organised by several universities crossing disciplinary boundaries.

[2] As provided for in Article 6 CISG.

1) the tasks (who has to do what, contract for carriage, clear for customs etc.),
2) the costs (who pays which costs related to delivery) and
3) the risks (who bears economic conequences of the loss of or damage to the goods)

in connection with a sale of goods transaction involving carriage of the goods. For Incoterms® 2020 see the following chart:

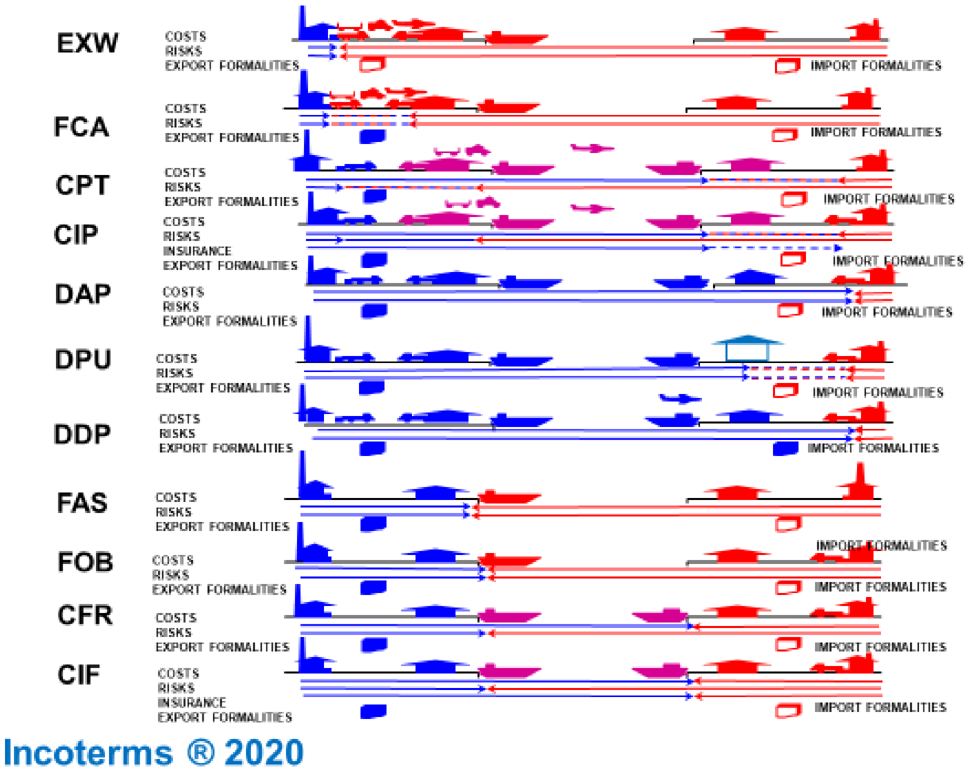


Figure 1: The above chart made with courtesy to Mr. Asko Räty, a Finnish Incoterms expert, illustrates the division of tasks, costs and risks under Incoterms® 2020 in a delivery under a sale of goods transaction

When parties select one of the Incoterms to constitute part of their contract, it will prevail over the applicable sales law. More than 90 countries in the world including most EU countries and China have made the United Nations Convention on Contracts for the International Sale of Goods 1980 (CISG, The Vienna Convention) part of their legislation to govern international sale of goods.

Furthermore, the parties may adopt contractual clauses to govern situations where supervening circumstances affect the parties ability to abide by the contract. these clauses normally take pre-cedence over commercial laws. We can illustrate the legal situation with the following drawings:

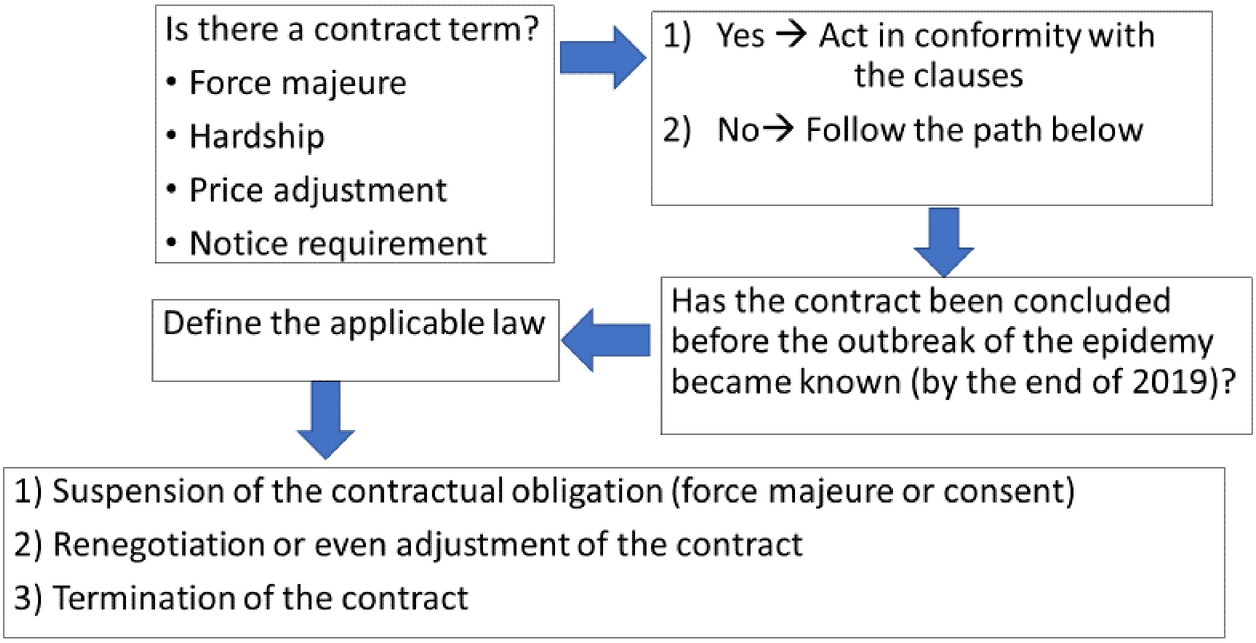


Figure 2: The sources of law and aspects to be taken into account in considering the legal effects of Covid-19 on contracts[3]

As we can see, the parties are bound by the express contract terms they have agreed between themselves. For our purposes in this article, we assume that such an agreement is valid. We also assume that the contract has been concluded prior to outbreak of the epidemy. As many logistical problems in early 2020, like non-availability of components were related to China, the contract should have been concluded before general knowledge of the outbreak and measures countering it in the country was available to be taken into account in concluding the contract. It has been stated by colleagues that courts in some countries apply the end of 2019 as the relevant date. In the course of January 2020, information about the epidemy was already spreading effectively. Obviously, such presumptions may be rebutted.

In the absence of a contractual provision, the provisions of the applicable law are to be studied in order to find guidance. National laws determine whether the performance of a contractual obligation may be suspended, whether the contract may be adjusted after a attempt of renegotiation and whether the contract may eventually be terminated.

<u>The pandemic creates delays and non-performance</u>

The readers of the articles in this online series are certainly acquainted with the various logistical problems caused by the Covid-19 pandemic. Some of them are mentioned here to illustrate the problems from a legal standpoint. Let us start from <u>the supply side</u>.

[3] With courtesy to Ms. *Marika Devaux*, Maat Law Firm, France

Companies producing advanced machines or equipment have reduced the cost of production of various components by scattering it to countries of lower production costs from which the components are transported mostly to Europe or North America. A common example of a very complex product is the European Airbus aeroplane, which comprises hundreds of thousands of components produced in dozens of countries. Even if the proportion of components is smaller, significant delays may still occur.

Companies having complex supply chains were first suffering from the shortage of components produced especially in China, which was first hit by the virus, and where measures were taken to isolate it by travel restrictions, quarantines and closings of production plants by authorities. The shortage of individual components inevitably affects the finalization of the end product unless replacing products or stores exist. However, modern logistics is geared to just-in-time deliveries in order to save costs by avoiding excessive storage. In turnkey contracts, the supplier is required to install the plant or equipment but may be prevented from doing so because of travelling restrictions to the country of the buyer.

The <u>demand side</u> may equally be affected by pandemic. As buyers must store the goods after taking delivery, and no or little demand exists for the goods, the buyer may be unwilling or unable to take delivery of the goods. It has been reported that LNG buyers in China and India are facing this situation as the supply side has also expanded through online sales.

The seller and the buyer need to organise transport by contracting for carriage or, very exceptionally, managing it through the use of their own equipment and vehicles. Normally, it is not difficult to organize carriage but the need of special equipment and lack of labor due to constraints may cause unsurmountable problems for carriage. It has been reported that even containers have been in short supply at times.

<u>Force majeure as a relief</u>

A supplier usually undertakes to deliver the goods under contractual provisions which presuppose the payment of damages, liquidated and/or actual ones, in case the delivery time is exceeded. The structure and effect of these clauses very much depends on the legal regime applicable to the contract.

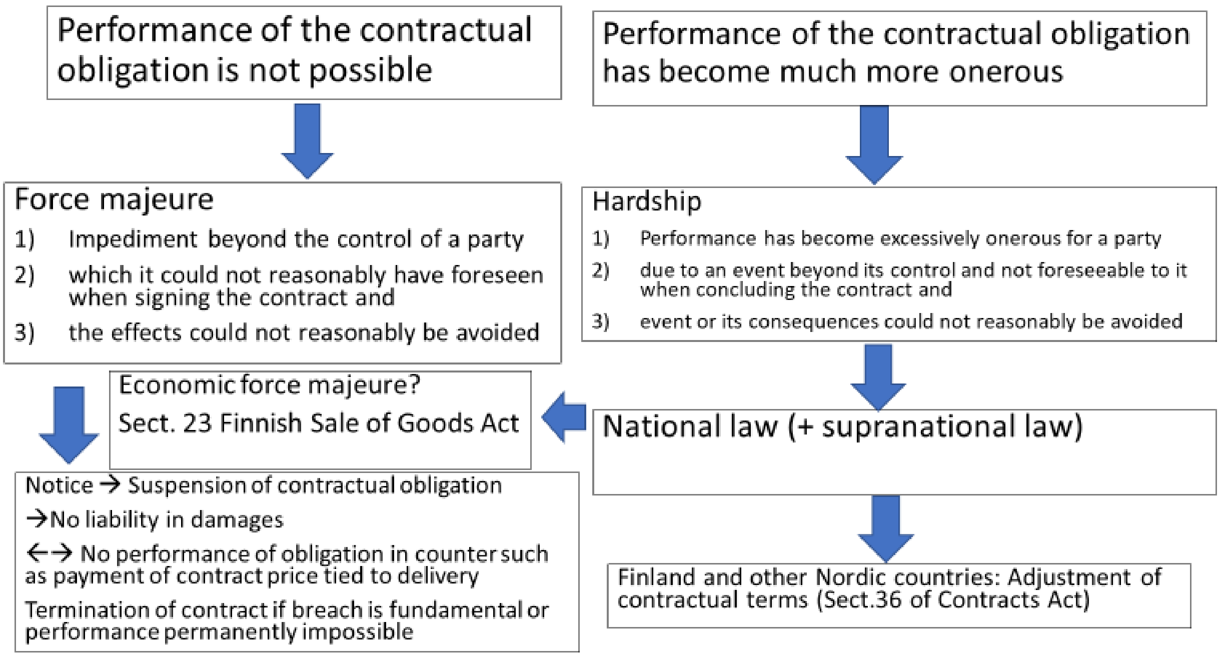
The supplier may, however, be relieved from paying damages, if there exists a force majeure event. Force majeure is a French law concept (Art. 1148 *Code Civil*) having found its way into most legal systems one way or another although its meaning and effects may vary from jurisdiction to jurisdiction. Generally, the performance of a party´s obligation under a contract is suspended, i.e. deferred to a later stage, and contractual remedies, essentially the obligation to pay damages, may not be invoked. In Anglo-American law, the related concept of ´frustration of contracts´ is applied. It generally means that the performance of the contract has become impossible over the events occurring after the conclusion of the contract not attributable to the parties and, as a result, there is a valid excuse for non-performance. The contract becomes in a way null and void through the operation of law: frustration does not merely provide one party with a defence in an action brought by the other. It kills the contract itself and discharges both parties automatically. It is not, however, necessary to draw too clear distinctions between the various legal concepts as the same elements may be found in different legal cultures.

As force majeure is part (Article 79) of the CISG, national laws and many standard forms of contract, it is extensively resorted to with a view to overcome the difficulties the world is envisaging with the outbreak of the virus. We should distinguish force majeure from the related concept of ´hardship´.

In a force majeure event, the peformance of a contractual obligation has become impossibile. For example, due to a lockdown imposed by authorities, a factory is closed and the production is thus impossible. Should the production still be possible somewhere else, or by using subcontracts, rendering the production ´excessively onerous´ through substantial extra costs involved, the situation is normally characterised as hardship. As stated in the beginning, hardship and the effect of supervening circumstances are not treated in detail in this article. Suffice to say only, that the effect of changing circumstances is normally more obvious on long-term contracts with several stages of performance whereas *force majeure* events cause impediments to the performance of individual contracts.

Interestingly, however, national laws may bring variation to the general picture. For example, section 23 of the Finnish Sale of Goods Act 1987 applicable to domestic sales in Finland, as well as to Inter-Nordic sales as the seller´s law, recognizes an economic force majeure event on top of virtual impossibility. The same goes for the national laws of the other Nordic countries. The seller may namely invoke as a *force majeure* event an impediment the overcoming of which would entail unreasonable sacrifices in comparison with the advantages accrued by the buyer. economic force majeure thus acts as a conceptual bridge between force majeure and hardship.

Figure 3: The two alternative paths to follow in the case of an event beyond the control of the parties. Nordic sales laws including the Finnish Sale of Goods Act allowing force majeure establish a bridge between the two approaches



The outcome of force majeure based on law is obviously dependent on the applicable law. We shall present the CISG approach as it is part of so many national laws. Under the CISG, force majeure relieves from liability in damages only. According to Article 79 CISG, the party invoking force majeure has a three-tier burden of proof as he needs to prove that the impediment is beyond his control, he could not reasonably have foreseen the impediment when signing the contract or to have avoided or overcome it, or its consequences.

The party who fails to perform must give notice to the other party of the impediment and its effect on his ability to perform. If the notice is not received by the other party within a reasonable time after the party who fails to perform knew or ought to have known of the impediment, he is liable for damages resulting from such non-receipt. This provision contained in article 79(4) of the Convention deviates from Article 27 of the same Convention which provides that delay occurring in the transmission or a failure to arrive does not deprive that party of the right to rely on that communication.

The approach adopted in Article 79 CISG means that other remedies, most notably termination of the contract (in the Convention´s own language ´avoidance of the contract´) may be possible under the circumstances if the non-performance amounts to a fundamental breach of the contract. Article 25 CISG lays down a test for fundamental breach:

> *"A breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result."*

As there is a breach of contract, only the party other than that breaching the contract may terminate it. Should the performance become permanently impossible, the purpose of the contract normally becomes obsolete and the contract may be terminated by either party. This is not stated in the Convention but follows from general principles of law.

The CISG is silent about the position of the party, whose performance is not impeded by force majeure. The main obligations of the buyer in a sale of goods transaction are taking delivery and payment of the price. Obviously, if performance by delivery is rendered impossible, there is no possibility to take delivery either. In practice, this means that risk for the loss of or damage to the goods or, for that matter, risk for delay will not pass to the buyer. Payment of price is invariably governed by contractual provisions. It is nevertheless commonplace that payment posts mirror developments in performance by the seller.[4] This rule, known in the German legal culture as the *Zug-um-Zug* principle, is also embodied in Article 58 CISG, which serves as a default rule. Consequently, the buyer would not have to pay the sales price in the absence of delivery unless otherwise agreed.

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[4] This is the rationale in documentary payments and supply chain finance.

The new ICC Force Majeure Clause(s)

Although force majeure is recognized by legislation or at least practice in various parts of the world, there exist many practices. Common law countries more generally build on lists of events presumed to constitute force majeure whereas civil law countries prefer a general wording.[5]

The International Chamber of Commerce has recently adopted its third ICC Model International Force Majeure Clause 2020 which is again published together with the new ICC Model Hardship Clause 2020.[6] The previous versions of these Clauses were published jointly in 2003 and the first Force Majeure Clause already in 1985. As national laws and contract practices treat force majeure differently, it is important to have in place an international benchmark and tool that can be incorporated into contracts easily and which may set the stage for the development of international contract law in general.

In fact, there are now two ICC Model Force Majeure Clauses, a Short Form and a Long Form. Essentially, both versions work similarly, but it was though by us drafters that the Short Form would be more attractive to smaller companies.

According to the definition of these Clauses, "Force Majeure" means the occurrence of an event or circumstance ("Force Majeure Event") that prevents or impedes a party from performing one or more of its contractual obligations under the contract, if and to the extent that the party affected by the impediment ("the Affected Party") proves:

a) that such impediment is beyond its reasonable control; and
b) that it could not reasonably have been foreseen at the time of the conclusion of the contract; and
c) that the effects of the impediment could not reasonably have been avoided or overcome by the Affected Party.

As we can see, the Affected Party has, like in Article 79(1) CISG, a cumulative burden of proof of showing circumstances which impede the delivery, the foreseeability of the impediment and the non-existence of any means to overcome it.

However, the rigorous burden of proof is practically reversed when one or more of the Presumed Force Majeure Events apply. In this way, the Anglo-American practices have found their way to the Clause. According to Clause 3.e) "**plague, epidemic,** natural disaster or extreme natural event" (emphasis by the author) qualify for Presumed Force Majeure Events. Equally**, acts of authorities like quarantines** could qualify as Presumed Force Majeure Events. In such a case, the Affected Party need not prove that the impediment is beyond its reasonable control, or that it

[5] International Distribution Institute has published a country-to-country report on contract and sales laws involving force majeure and the impact of pandemic on supply, franchising and agency contracts. The Finnish section of the Report was written by Mr*. Patrick Lindgren*, Attorney at Law, together with the author of this article. For the Report, see https://www.idiproject.com/sites/default/files/news/IDI%20Corona%20IDI%20Q&A%20FI-NAL%2020200429%20(I).pdf

[6] The author of this article was a member of the ICC Drafting Group for both Clauses chaired by Professor *Fabio Bortolotti* from Italy. The Clauses may be found on the ICC website at https://iccwbo.org/content/uploads/si-tes/3/2020/03/icc-forcemajeure-hardship-clauses-march2020.pdf.

could not reasonably have foreseen the impediment at the time of the conclusion of the contract. The Affected Party only needs to prove that the effects of the impediment could not reasonably have been avoided or overcome by it. However, a Presumed Force Majeure Event is just a presumption. It is possible for the other party to adduce evidence according to which the impediment is within the reasonable control of the Affected Party or that the impediment could have been foreseen at the time of the conclusion of the contract.

A party successfully invoking the ICC Force Majeure Clauses is relieved from its duty to perform its obligations under the Contract and from any liability in damages or from any other contractual remedy for breach of contract, from the time at which the impediment causes inability to perform, provided that the notice thereof is given without delay. If this is not the case, the relief is effective from the time at which notice thereof reaches the other party. It is submitted that where CISG applies as the applicable fallback law of the Clause, even the notice given without delay must reach the other party to have legal effects.

A novelty in the ICC Clauses is that they now expressly regulate the position of the contracting partner of the Affected Party, who usually is the one paying for the goods in a contract of sale. The other party may suspend the performance of its obligations, if applicable, from the date of the notice. he obligations need be capable of being suspended. Reference is made what has been stated above about the obligations of the non-affected party in the context of CISG. Typically, at least part of buyer´s payment obligations are tied to the delivery.

What makes the ICC Clauses theoretically different from the CISG is that non-affected party may not resort to any contractual remedies during the impediment. However, if the impediment is of a long duration, the default provision in the ICC Clauses being 120 days, either party may terminate the contract. In accordance with the above, there are normally no damages to be paid in such a situation. A glimpse to a picture hopefully clarifies the situation somewhat:

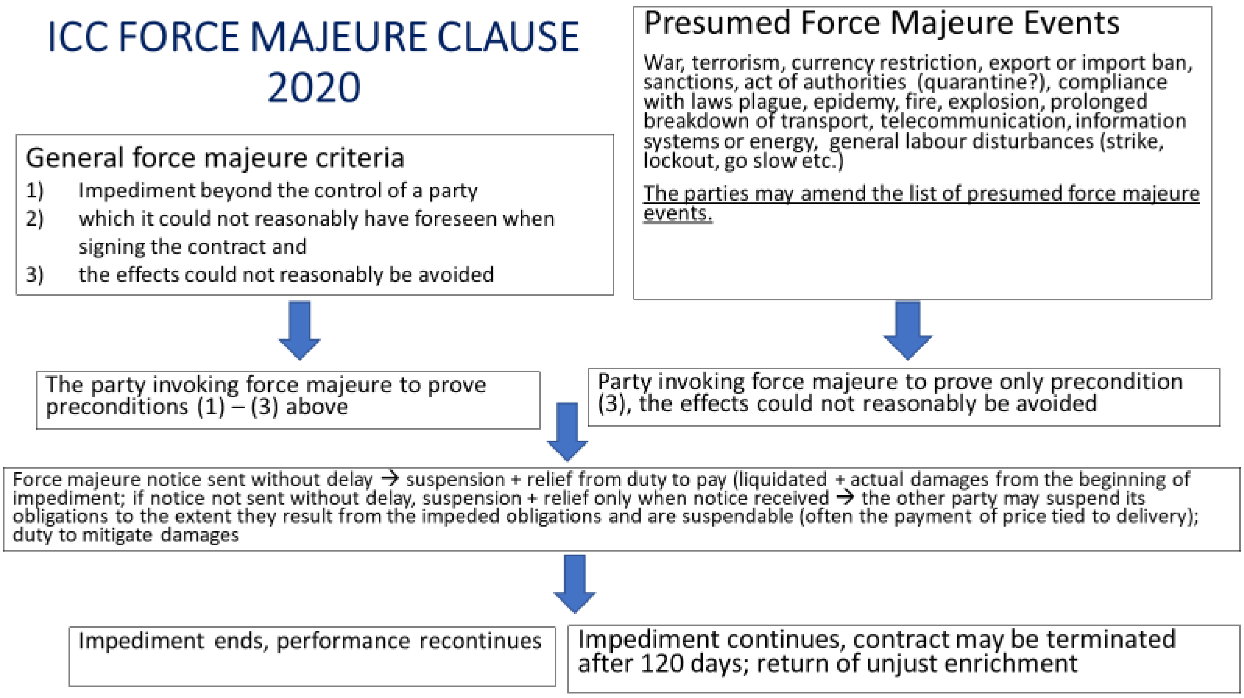

Figure 4: The ICC Force Majeure Clause 2020: general force majeure criteria and Presumed Force Majeure Events as well as the consequences of force majeure

It is worthwhile to pay attention to the word ´reasonably´ in the general criteria. it is arguable that the word attracts arguments of fairness and economic force majeure.

Force majeure in a chain of contracts

Where a contracting party fails to perform one or more of its contractual obligations because of default by a third party whom it has engaged to perform the whole or part of the contract, the contracting party may invoke force majeure only to the extent that its requirements are established both for the Affected Party and the third party. The Affected Party must prove that the force majeure conditions are met for the non-performance of the third party, who may benefit from the fact that the coronavirus as plague or epidemic is treated as a Presumed Force Majeure Event. The same follows from the provisions of the CISG.

A third party may be a supplier or subcontractor. Therefore, a distributor may invoke force majeure only if both the supplier (principal) and the distributor are affected by the impediment. A distributor may need to prove that it could not reasonably have avoided or overcome the Presumed Force Majeure Event. As it is normal to rely on just-in-time deliveries and that for branded products only individual sources of supply exist, this should normally not be too difficult.

Force majeure and taking delivery

As already stated above, one of the two main obligations of the buyer of goods is to take delivery of them. There are situations where taking delivery is virtually impossible, e.g. when the personnel of the buyer may be under lockdown or quarantine. Where the demand has decreased or there is too much supply otherwise, the buyer may encounter impediments in taking delivery where there is not enough capacity to store the goods. This has proven to be the case with LNG deliveries to China and India.

A dispute may arise between the seller and the buyer about the right to invoke force majeure is such circumstances. This may also have a bearing on the payment conditions. The situation is often more complicated as the cargo remains on board a vessel or other means of transport or is stored in containers. This creates a tripartite problem, to which we shall pay attention next.

<u>Force majeure and problems in organizing transport</u>

Under EXW and the F-terms FCA, FAS and FOB Incoterms, it is the buyer to organize the carriage, which means that the supply chain and risks involved including delay fall on the buyer. As the buyer contracts for carriage, the carrier has contractual recourse to the buyer. The problem often is that the seller acts as the shipper (or ´consignor´ or ´sender´ depending on the mode of transport and terminology used in legislation or contracts)[7]. it is not uncommon for carriers to provide in the transport conditions for excessive liabilities on the shipper, who may not have contracted for carriage at all.

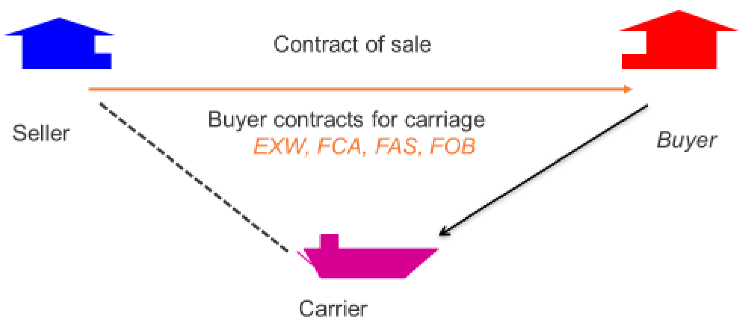

Figure 5: The contractual relationships between the seller, buyer and carrier under EXW, FCA, FAS and FOB Incoterms® 2020

If the buyer can organize transport, the buyer is normally able to take delivery. It should be

[7] See further on this *Railas*, *Lauri*: The Identity of the Shipper and Incoterms 2010, European Transport Law 3/2016.

added that under Ex Works (EXW) taking delivery happens already in the seller´s premises. Should there be problems in obtaining transport capacity, the buyer is in breach, but the buyer can invoke force majeure to suspend performance where the preconditions stated above are met. It should be recalled that a breach by the buyer to nominate a vessel already transfers risks for the loss of or damage to the goods to the buyer. It is unclear whether a premature passing of the risk would take place under a force majeure event. This of course depends on the applicable legal regime. According to the ICC Force Majeure Clause 2020, performance is suspended and remedies are not applicable. However, the ICC likes to stress that Incoterms® 2020 does not govern remedies.[8] Consequently, if the premature passing of risk is not a remedy, risk would pass prematurely also in a force majeure event.

Under the C-terms CPT, CIP, CFR, CIF, as well as under the D-terms DAP, DPU and DDP, it is for the seller to organise carriage. Under the C-terms, the seller effectively must contract for transport. The D-terms are relatively clear in that the seller bears the costs and risks during the transportation. Should the buyer validly reject delivery on the grounds of force majeure, the carrier can easily have recourse to the seller as the shipper.

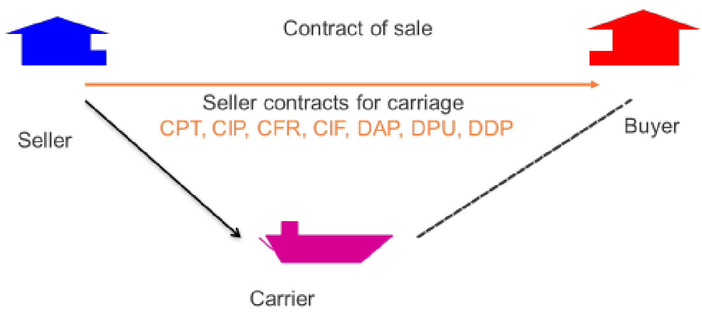

Figure 6: The contractual relationships between the seller, buyer and carrier under the C- and D-Terms of Incoterms® 2020

The C-terms, most often CFR or CIF, are frequently used for the carriage maritime bulk cargoes. The seller contracts for carriage with an independent carrier. The risk for the loss of or damage to the goods, as well as the risk for delay, passes already at shipment. The seller is expected to do everything he needs to do at his end only. Any additional costs arising during the carriage, including demurrage at the port of discharge, are to be borne by the buyer. The carrier

[8] See the Introduction of Incoterms® 2020.

invariably ´enforces´ such claims by applying lien on the cargo. However, this is not of help if the buyer refuses to take the cargo. The problem for the buyer is that the buyer has taken delivery already at shipment. Furthermore, force majeure based on the contract of sale does not apply in the relationship between the carrier and the buyer as the consignee. One has to look at the conditions of carriage which may become applicable in the relationship between the carrier and the consignee through the transfer of the bill of lading or otherwise.

Maritime contracts of affreightment contained in or as evidenced by charterparties or bills of lading invariably contain deviation clauses and similar effects may follow from applicable maritime laws. As the seller must contract for carriage under ordinary terms, this means that the seller has taken care of his performance obligations by contracting for carriage under such terms. Should a port strike, lockout or quarantine at the port of discharge emerge later, the carrier can normally validly discharge at another nearby port.

Should discharge eventually be impossible, the carrier is expected to take a look at the contract and turn to the seller having contracted for carriage. We may recall how sea carriers allegedly instructed their vessels when Russia instituted countersanctions in 2014: *"Banned cargo presently en route to Russia will be returned and all costs arising will be for the shipper's account, including local costs and freight."* The contracts of affreightment normally provide enough ammunition for such claims.

How to apply *force majeure* to the pandemic?

The coronavirus creates impediments, which in the first place are not economic by nature since officials in practically all countries (except maybe Belarus) are issuing mandatory orders affecting companies. A bordeline issue could nevertheless be economic *force majeure* in the occurrence of which the impediment in the supply chain can be overcome by paying substantially more. Many complex situations may nevertheless need to be resolved. For example, what happens, if there is simply a corporate policy – and not an prerogative by officials - requiring workers to stay at home? Is the company exempted by exercising precaution? Case law is still under evolution.

The first version of this article was written in March 2020. It is surprising to see, how much the world has changed in eight weeks only. I thank you for your attention.

Helsinki, 7 May 2020

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