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Legal Update

An Impact of the US-China Trade War on Force Majeure Clauses

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As of this article's publication, the US and China appear to be close to coming to an agreement on the tariff war that has rattled financial markets. But the on again off again relationship of the world's largest economies, and the uncertainties associated with that relationship, may well be a feature of the international contracting landscape for years to come. A recent issue of concern is therefore whether a supplier is liable to perform (even if costly) or pay damages to customers, if tariffs or quota barriers are applied to a supplier's exports. In this article, we will explore how Force Majeure clauses may be invoked to avoid the obligation to perform an agreement that is no longer workable in a tariff or quota situation.

The Weapons of Trade War: Quotas and Tariffs

If exporters or importers find themselves in the cross-hairs of a trade war, legal counsels' would often turn to force majeure clauses to avoid liability at first instance. However, the efficacy of that argument depends on the wording of the particular force majeure clause in the offending contract. The type of trade barrier also makes a difference.

There are 2 main forms of trade barriers:

1 Imposition of, or, reducing import quotas

This is more commonly practiced by the Chinese side, as there are existing import quotas in place for certain goods. For example, cotton is subject to quota controls by China.

In a trade war, China might be compelled to lower quota levels or impose quotas on previously unrestricted goods.

2 Tariffs

Tariffs are practiced by both the US and China, and is widely understood to be a form of taxation that increases the price of overseas imports, thereby reducing the availability of such imported goods in the domestic market.

Impossibility of Performance in Quota Situations

If import quotas affect particular goods, it can be arguable whether a force majeure clause will be triggered. This due to the quota system itself and the way it is administered. For instance, importers might have to bid or apply for quota allocation from the relevant regulator or central government before being able to import goods into the country or take them out of the port customs area.

Therefore, if the onus is on the importer to apply for the quota, the importer may need to take steps to apply for the quota and receive a negative reply before a force majeure clause may be triggered to excuse performance.

A secondary option may be to argue that the inability to receive a quota frustrates the contract or gives rise to the impossibility of performance of contract. This is because it is simply not possible to import the goods into the country without the proper import permit i.e. the root of the contract cannot be performed. The contract will however be terminated if frustrated – a more dire consequence than using force majeure to preserve the contract and to suspend performance (and resist damages for breaches).

There is the further complication of situations where goods have been exported and have arrived at the port, but quotas are announced and come into effect while goods are in transit. As a result the goods are seized on arrival or end up languishing at the customs area while permits are sorted. This becomes an even more urgent issue if the goods are perishable. In such instances, the question of performance is unclear, at least at first instance, since waiver permits could potentially be issued or the seized goods released since they have already arrived in port. Moreover, the exporter would anyway desire to be paid since it is already out of pocket for the goods. Much would turn on delivery terms contained in the contract.

Tariffs on the other hand do not typically give rise to impossibility of performance issues, since import of tariffed goods is still technically possible, although the cost associated may be exorbitant or even ruinous for some companies.

Force Majeure Clauses and their Effect

Force majeure clauses may come to the aid of parties seeking to avoid performance due to either tariffs or quota restrictions. However, much turns on the exact wording of the clause.

In traditional legal drafting, force majeure clauses only covered "Acts of God", possibly followed by a clarification that these covered natural disasters and events beyond human control.

More contemporary drafting techniques would include a variety of illustrations beyond the usual natural disasters such as "hurricane", "earthquake" (the list is ever growing, for instance "quarantine" and "epidemic" joined the illustrious list when SARS and Bird Flu broke out).

Present day force majeure clauses attempt to extend the concept of "Acts of God" by the rather clever (and vague) use of the phrase "unforeseen circumstances".

The risk is that the use of "Acts of God", and the litany of disasters topped with "unforeseen circumstances" is not broad enough to cover trade wars, and so the force majeure may not always be triggered to protect the party seeking to escape performance under a contract affected by trade barriers.

It may be arguable for instance that a trade war was "foreseeable" or "reasonably foreseeable" at the time the contract was entered into. For instance, the contract could have been entered into during the past year, when news and editorials on the trade war have been constantly in the press. In which case, it might be difficult to argue that tariffs subsequently affecting the contracted goods were unforeseen. It is also very much arguable whether trade disputes, which are essentially "acts of government", qualify as "Acts of God".

We have recommended as part of risk management, for certain multinationals to have in place a public Disaster Recovery Plan or Back Up Plan – events which are outside of such Plan are deemed to be outside the control of the performing party, and can therefore sensibly be excused as a force majeure event. This gives certainty to the contracting parties and eliminates almost all "chance", but may be deemed overly restrictive (or ambitious!) for some corporations.

In the present circumstances, we have observed increasing examples of clauses which specifically reference "tariffs" or "sanctions" and whether force majeure would apply or not apply to them. It is best to be clear, and generally common law jurisdictions selected to govern a contract (e.g. Singapore law) would uphold the parties' contractual allocation of risk.

Conclusion

Taking into consideration the various options for delivery terms, payment terms and force majeure wording, there are many permutations which may result in either the importer or exporter relying on force majeure to temporarily delay performance and thereby avoid a financially burdensome obligation.

For instance, an exporter who is obligated to deliver goods to the customer's delivery address, with payment on delivery only, would likely wish to argue that force majeure does apply to the contract if tariffs are imposed. In this way, the exporter can hopefully ride out the trade war, and only be obligated to perform the delivery once tariffs are reduced or removed, or, for the contract to be terminated due to a tariff being in effect for longer than the contractual time limit.

On the other hand, an exporter whose delivery obligations are discharged upon handover of goods to the freight carrier and whose goods becomes the subject of a quota only in transit would likely argue that force majeure or impossibility of performance would not apply – in order to get paid for goods which would likely now be physically unrecoverable.

It is therefore important for businesses to properly analyse the impact of such clauses on the businesses they are advising, and allocate risk appropriately or fairly when drafting the agreement.

This article does not constitute legal advice and is intended to provide general information only based on the currently available information. Please contact our lawyers if you have queries on any specific legal matter.

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