TARIFFS AND SUPPLY CHAINS: AN ENGLISH LAW PERSPECTIVE ON CONTRACTUAL LEVERS YOU MAY HAVE (OR WANT)

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These are challenging times for supply chains. In recent months, the US government has announced, reversed, delayed, adjusted, and enacted a series of tariffs on imports to the United States from a long list of countries; some countries have retaliated, and others are negotiating and beginning to announce trade deals. The supply chain is trying to adapt fast and frequently.

Whether tariffs are imposed for additional tax revenue, to encourage domestic production and consumption, as a geopolitical tool to favour some countries over others, a combination of these or otherwise, they are having significant impact. From increasing material and production costs, to squeezing operating margins, increasing administrative and trade compliance burdens, inflating end-product pricing, and affecting supply and demand cycles with stockpiling in advance of anticipated tariffs or import delays in case tariffs are soon to be removed or reduced.

While supply chain restructuring or diversification may be a medium or longer-term priority, its participants may wish to be agile and respond swiftly in the short-term, but where does the tariff burden lie, how flexible are the contracts, and what contractual levers might be available to mitigate the impact?

We consider below (from an English law perspective – though the comments may have general application) some contractual levers that may help navigate these challenges. One comment of universal application is that: whether any tariff announcement is sufficient to trigger a contractual lever, and the consequences which may flow from it, will be contract clause and context specific.

WHERE DOES THE TARIFF BURDEN LIE?

Does the contract contain provisions which allocate the parties' risks and responsibilities in the event of tariffs? If not, each party may bear the increased costs of performing their respective obligations.

DOES A TARIFF TRIGGER AUTOMATIC CONSEQUENCES?

Dynamic pricing provisions may vary the price payable by reference to an underlying index, which may shift in response to a tariff, or they may build-in formulae to adjust prices by reference to an increase in the cost of supply, which could include the imposition of a tariff. These provisions may provide that price adjustments are time limited, subject to a maximum cap, or kick-in only once a cost threshold is exceeded.

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WHAT CONTRACTUAL LEVERS ARE AVAILABLE?

Does the contract provide opportunities for the parties to require or request variations, to suspend performance, or even to terminate, in the event of tariffs or significant cost increases?

Surcharge

Surcharge pricing may allow a party to apply an additional fee beyond the original contract price, to cover a particular cost. End users will often be expected to pay increased prices for consumer goods affected by tariffs, and a similar principle may apply to business-to-business contracts if a clause permits a party to levy surcharges. As with dynamic pricing provisions mentioned above, these may be subject to threshold and time limits, and they may provide a unilateral right to adjust pricing, or trigger a renegotiation.

Change in Law

The contract may specify the consequences of a change in law after its execution. The clause would need to be examined to assess whether: a tariff could qualify as a change in law; it requires contractual adjustments or triggers a renegotiation; it allocates the consequent burden of additional cost of compliance; it addresses the ramifications of any delays caused, or even perhaps provides a right to terminate. Such a clause may only apply if the change in law requires that the contract be amended (for example, in order for it to remain compliant with the law that has changed), so whether a tariff could be said to require a variation or merely affect the economics of the arrangement could give rise to debate/dispute.

Force Majeure / Frustration

Is often the first thing that comes to mind when a significant event impacts a contract, but circumstances in which such a clause may be successfully utilised can be limited. There is no standalone doctrine of force majeure under English law, so step one is to see if there is such a clause. A force majeure clause is usually composed of two parts: the first lists a series of events considered to trigger the force majeure provisions, and the second determines the consequences, which may for example include a right to suspend performance temporarily and/or to give notice to terminate, if certain circumstances apply. Whether a tariff constitutes a force majeure event will depend on the clause wording.

Even if tariffs are specifically referenced, force majeure clauses can require that the triggering event make it legally or physically impossible to perform, rather than merely more expensive, and English caselaw indicates that such clauses will not generally be construed to extend to changes in economic circumstances. So, force majeure may not be an especially useful lever in respect of tariffs. That said, if the imposition of a tariff has knock-on consequences, such as a key component or ingredient becomes temporarily unavailable rendering it impossible to manufacture a product, there may be better prospects of force majeure responding to assist.

Absent a force majeure clause, parties to English law contracts sometimes consider the doctrine of frustration (discharging a contract when an unforeseen event makes the contract incapable of being performed), though the English courts have consistently held that increased costs or reduced profitability will not be sufficient to frustrate a contract – so unless the impact of a tariff is so extreme as to create impossibility, it is unlikely to assist.

MAC / Hardship

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Is there a “material adverse change” (MAC) or a hardship provision? MAC clauses may allow a party (e.g. a buyer in an acquisition) to renegotiate or withdraw from a transaction if a certain event occurs which has a material negative impact. The potential applicability and effect of the clause would need careful consideration in each case. It may list specific triggering events, refer more generally to any matter which has a materially adverse effect, or incorporate carve-outs that may prevent tariffs from being considered a relevant event. What consequences are specified, and does it trigger a renegotiation or provide a right to terminate or withdraw?

Alternatively, there may be an economic hardship clause, permitting a party to trigger a renegotiation if something occurs making performance significantly more difficult / financially onerous (though not impossible). Carefully defining what constitutes “hardship” will be important, as this may be an area ripe for dispute when something drastic occurs. Hardship clauses are not especially common in English law contracts, though sometimes appear in cross-border long-term supply relationships, or where markets may be volatile.

Change Control / Variation

some longer-term or complex contracts may have a prescribed process to propose, evaluate, negotiate in good faith, and implement changes to contract economics following a change to the scope of work or a cost increase for example.

The boilerplate provisions in many contracts incorporate a variation clause expressly permitting contract amendment by agreement between the parties, and parties are generally free to agree and implement variations to their contracts in any event (subject to any express restrictions in the contract).

Their utility can be limited where they do not specify what changes should be made on the occurrence of a triggering event, constitute only an “agreement to agree”, or provide no more than an option to negotiate, though incorporating an obligation to negotiate in good faith may be more helpful than nothing at all. In certain circumstances (such as where the parties have a particularly strong desire to continue working together, or where all parties find themselves similarly impacted by an event), a mutually agreeable change control or variation clause may assist to achieve a commercial resolution. That being said, where a collaborative relationship persists despite challenging circumstances, the parties may elect to vary the underlying agreement regardless of any express variation process. It would be extremely unusual for a commercial agreement to prohibit its parties from amending the agreement in writing executed by all parties.

Termination

If nothing sufficiently reduces the damage that will be done by continuing to perform, looking at contract termination possibilities may be the only option.

Some of the provisions mentioned above may allow notice of termination to be given if certain circumstances have arisen. If not, does the contract permit termination for convenience by giving a period of notice? Where such a right exists, it may however be accompanied by exit costs and these should be balanced against the costs associated with the tariff to ascertain which route makes most economic sense. Or has the imposition of the tariff brought about a breach of the contract sufficiently serious to warrant a termination – for example, if the tariff brings about a failure to supply or a refusal to order, accept delivery or pay – whether under a provision allowing notice of termination to be given in the event of a material breach or under the common law for repudiatory breach?

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COMMENT

Scope for complex contractual disputes abound: contrasting interpretations of contractual provisions; whether they are enforceable; whether a clause encompasses a particular event; whether that event has occurred; can US tariffs be classified as “unforeseen” events when they featured so prominently in the election campaign?; has a force majeure event occurred?; if so, has the obligation become impossible (not just expensive) to perform?; what constitutes a material adverse change or a hardship?; is a party engaging in negotiations in good faith?; has a right to terminate arisen?; whether the tariff has brought about a breach of contract; does a breach give rise to a right to terminate under the contract or English common law? And these are just a number of examples arising from the concepts considered above.

The firm's Commercial Disputes and International Arbitration lawyers regularly assist clients seeking to rely on, or challenge an opponent's reliance on, the types of levers discussed above, and with resolving any complex contractual disputes arising. The team works closely with our international trade team, which is advising our global clients in real-time as the trade landscape continues to shift.

We noted above that the availability and utility of these rights and levers will be contract clause and context specific, and the wording of each provision will be very important. Do your supply chain contracts include some or all of the levers you need, and will they operate as you would like?

There is a delicate balance to be struck between incorporating levers for sufficient flexibility and allowing the parties to navigate their business through unexpected and significant disruptive events (such as tariffs), whilst at the same time maintaining levels of contractual certainty that may be required to justify investment in a relationship, and so that everything is not forever up for renegotiation. Our commercial contracts and other lawyers assist clients to assess the context-specific strategic benefits of these levers, advising on the drafting, negotiation and incorporation of such provisions. Ultimately, it is about tailoring the balance between flexibility and certainty to the specific industry and business needs of our clients in order to future proof their commercial relationships.

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