Some Comments on the Current Supply Chain Crunch

Julius H. Hines[1]

It is hard to believe that, just a few years ago, the Korean shipping line Hanjin was officially declared bankrupt in a South Korean court. Hanjin slipped into insolvency in 2016, tipping off a wave of ship seizures around the world. Around that time, maritime trade press was full of stories about overcapacity in the container shipping industry. Shipping lines had ordered too many new, high-capacity container ships in anticipation of the widening of the Panama Canal. Then came the great recession of 2008-2009. With economy activity generally down, there was less trade business to fill the newly-launched, giant containerships. Rates were low and container carriers competed hard for available business. Older, less efficient container ships were quickly scrapped as the cost of keeping them on the water began to exceed the money they could earn in a tight market.

Then came the COVID-19 pandemic early in 2020, which shuttered factories in China and elsewhere—to which container lines quickly responded by cancelling service. Demand, however, began to rebound as 2020 waned and 2021 dawned. March of 2021 saw a new wrinkle—a containership managed to get wedged in the Suez Canal, bottling up shipping along that critical trade route for weeks. This ill-timed mishap accelerated the recovery of container shipping rates, already on the rise as Asian factories began reopening. By September of this year, the cost of shipping a container from the Far East to the America had increased roughly ten-fold. Rates have tracked down some in the past few months but are still extremely high compared to pre-pandemic rates.

---

[1] Julius H. Hines is a partner at the Charleston firm of Hines & Gilsenan LLC and an adjunct professor at the Charleston School of Law. This piece was written on the occasion of the meeting of the International Law Committee at the 2022 South Carolina Bar Association Annual Convention in Greenville, South Carolina.

The problem isn't only the rates. Shippers are having trouble finding space on existing containership voyages. There are also reports that empty containers are hard to come by in China and elsewhere overseas. Empty shipping containers tend to accumulate in ports where a lot of import cargo arrives. Ideally, trade should balance so that every empty import container can be loaded with export goods and shipped back overseas. But the United States still runs a trade deficit with China and other countries, so some number of empty containers must be returned to the major export ports.

These disruptions, it should be remembered, came hard on the heels of new tariffs on Chinese-origin goods. Tariffs came into force starting in 2018, adding as much as 25% to the cost of imports from China.[2] Thus for businesses sourcing inventory and equipment from China, the cost of inputs surged first from newly-imposed tariffs, and again with a massive increase in the cost of shipping those goods to the United States. For years, parties to international trade could pretty much assume that two cost inputs, namely import duties and freight costs, would remain stable or even decline. That changed, first under the trade policies of the last presidential administration, and again as a result of the 2020 pandemic.

Meanwhile South Carolina invested heavily in anticipation of the post-Panama Canal expansion era. Dredging of the Charleston Harbor entrance channel to accommodate deeper-draft container ships will soon be complete. A new container terminal on the former Charleston Naval Station is now operational, although labor issues stand in the way of its being put to full use.[3] The Port of Charleston felt a relatively modest dip in container traffic in 2020, but has already hit a new record in 2021.[4] Today it experiences less of the congestion that has plagued other ports,

---

[2] See 83 Fed. Reg. 28710 (June 20, 2018).
[3] See "Labor judge rules for Charleston in ILA dispute over new terminal," JOURNAL OF COMMERCE (online) September 17, 2021.
[4] See http://scspa.com/wp-content/uploads/teu-history.pdf.

such as Los Angeles and Savannah. But high freight rates and scarcity of on-board space remain a challenge for local and regional businesses using the Port of Charleston to import supply or export finished goods.

These international trade disruptions can raise various legal issues. In trade, a classic term is the place of delivery. The seller must deliver the goods somewhere—the terms of the contract, and in their absence the applicable contract law, will fix the place of delivery. South Carolina's adoption of Article Two of the Uniform Commercial Code ("UCC"), for example, states that the seller's place of business is the point of delivery unless otherwise agreed in a contract.[5] Meanwhile the United Nations Convention on the International Sale of Goods ("CISG"), to which the United States is a party, states that, where the contract involves carriage of goods (usually the case in international trade) the default mode of delivery is to hand the goods over to the carrier.[6]

Of course, most international trade contracts will specify the place of delivery—often by reference to "Incoterms®," a set of standardized sales terms widely used in trade. The available delivery options range from the seller's plant ("ex works" in trade parlance) to the buyer's warehouse ("delivered duty paid" means the seller clears the goods from import customs and gets them to the buyer's place of business). One commonly-used term where container shipment is involved is "DAT," or "delivered at terminal." "DAT Charleston" would mean the seller had to deliver the goods to the port of Charleston; whereas "DAT Shanghai" would mean the seller was finished once the goods reached the port of Shanghai, in a container and ready for loading on board a ship.

---

[5] S.C. Code § 36-2-208.

[6] CISG Art. 31(a).

One can envision the supply chain problems that can ensue. What if, in the "DAT Charleston" example, the seller can't find space on a container ship in time for delivery per the terms of the contract? What if shipboard space is available, but no empty containers can be found in the Shanghai area? A seller who can otherwise perform the contract may find itself in breach due to supply chain issues no one worried about prior to the pandemic.

Similarly, a wholesaler or distributor in South Carolina bound to deliver goods to customers in the United States by a certain time may risk breach on account of its own overseas suppliers' inability to get the goods here in time—due to the same supply chain issues. These issues relate only to the timeliness of delivery; consider the situation of party seeking to import Asia-origin containerized goods to fulfill its own sales contacts. That party might have budgeted $1500 per container in freight charges, only to be faced with rates in excess of $10,000 per container when delivery comes due. Not only are traders in goods affected by supply chain issues. Construction contracts are also vulnerable. Materials like steel or lumber may need to be shipped from overseas. A construction contract may call for installation of machinery sourced from abroad. Shipping delays, or freight costs far in excess of what was contemplated when a contract was signed, may imperil performance of the contract.

Impossibility and Impracticability

Contract law is typically unsympathetic to parties in this predicament. As the Restatement of Contracts observes, "[c]ontract liability is strict liability."[7] A party who accepts the obligation of delivery of goods by a certain time, and agrees to include the cost of delivery in the price, is usually stuck if delivering on time proves difficult or the cost increases far beyond what the party contemplated. The *Restatement* covers two related concepts, impracticability of

---

[7] 2 RESTATEMENT (SECOND) OF CONTRACTS 309 (1981).

performance and commercial frustration. Where a party's performance is rendered "impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made,"[8] that party's duty to perform is discharged. The *Restatement* gives a very pertinent example:

> A agrees to sell and B to buy goods to be delivered in October at a designated port. The port is subsequently closed by quarantine regulations during the entire month of October, no commercially reasonable substitute performance is available …, and A fails to deliver the goods. A's duty to deliver the goods is discharged, and A is not liable to B for breach of contract.[9]

Some ports did indeed close due to pandemic-related quarantines.[10] The impracticability rule clearly applies when the only suitable port for delivery of goods is closed entirely due to COVID restrictions. But most ports are open, so this extreme situation is relatively rare. The more prevalent obstacles are the relatively scarcity of empty containers and shipboard space, plus the exorbitant cost of shipping.

It seems reasonable to say that a ten-fold increase in freight rates can make performance of a contract impracticable. The problem, however, is whether existing freight rates, or something close to them, is a "basic assumption" of a contract for the sale of goods. On this the *Restatement* has the following to say: "The continuation of existing market conditions and of the financial situation of the parties are ordinarily not such assumptions, so that mere market shifts or financial inability do not usually effect discharge" under the impracticability rule.

Under the doctrine of commercial frustration, one party's duty to perform is discharged when, due to the failure of a "basic assumption on which the contract was made," that party's

[8] RESTATEMENT (SECOND) § 261.
[9] *Id.* at Illustration 1.
[10] See, e.g., "Covid-19 Closure at China's Ningbo Port Is Latest Snarl in Global Supply Chains," WALL STREET JOURNAL, August 20, 2021.

"principal purpose" in entering into the contract is "substantially frustrated."[11] A classic example is the party who pays to reserve a window to view a parade, only to have parade canceled.[12] Exorbitant freight rates can certainly frustrate a party's commercial expectations, but according to the *Restatement* this won't quite do: "It is not enough that the transaction has become less profitable for the affected party or even that he will sustain a loss. The frustration must be so severe that it is not fairly to be regarded as within the risks that he assumed under the contract."[13] One can argue that ten-fold increase in freight rates meets that standard of severity, but again the *Restatement* holds out little promise. One illustration to the section on commercial frustration states that, even if a gas station lessee's business collapses due to a change in traffic regulation or imposition of gasoline rationing, the "principle purpose" of operating a gas station is still not substantially frustrated.[14]

South Carolina law isn't any better. Traditionally, the South Carolina doctrine of "impossibility" has been stated as follows: "If a party by his contract charges himself with an obligation possible to be performed, he must make it good, unless its performance is rendered impossible by an act of God, the law, or other party."[15] "Impossibility must be real and not a mere inconvenience."[16] "Subjective impossibility," which is "personal to the promisor and does not inhere in the nature of the act to be performed, does not excuse nonperformance of a contractual obligation."[17] In *Morin v. Innegrity, LLC*, [18] the South Carolina Court of Appeals

---

[11] RESTATEMENT (SECOND) OF CONTRACTS § 265.
[12] See id. at Illustration 1.
[13] Id. at Comment a.
[14] Id. at Illustration 6.
[15] Jones v. Bates, 241 S.C. 189, 193, 127 S.E.2d 618, 619 (1962); Pearce-Young-Angel Co. v. Charles R. Allen, Inc., 213 S.C. 578, 586, 50 S.E.2d 698, 701 (1948); V.E. Amick & Assocs., LLC v. Palmetto Envtl. Grp., Inc., 394 S.C. 538, 546, 716 S.E.2d 295, 299 (Ct. App. 2011)
[16] Hawkins v. Greenwood Dev. Corp., 328 S.C. 585, 593, 493 S.E.2d 875, 879 (Ct. App. 1997).
[17] Moon v. Jordan, 301 S.C. 161, 164, 390 S.E.2d 488, 490 (Ct. App. 1990).
[18] 424 S.C. 559, 819 S.E.2d 131 (Ct. App. 2018).

noted a trend to "modernize" the doctrine of impossibility so as to relieve a party from the unfairness or unreasonableness of absolute enforcement of the contract.[19] The only "nod" the Court of Appeals could find in South Carolina law, however, was Section 615(a) of our enactment of Article Two of the UCC. That section provides that

> Delay in delivery or nondelivery in whole or in part by a seller … is not a breach of his duty under a contract for sale if 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 or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.[20]

Section 615(a) includes the same "basic assumption" formula as the *Restatement*. As previously discussed, the *Restatement* suggests that the continuation of prevailing market conditions is not a basic assumption of the typical contract. The official comments to UCC § 615(a) are to the same effect:

> Increased cost alone does not excuse performance unless the rise in cost is due to some unforeseen contingency which alters the essential nature of the performance. Neither is a rise or a collapse in the market in itself a justification, for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover.[21]

That said, the same Official Comment adds that a "severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance" can be covered by § 2-615(a). This comment certainly applies to the seller whose supply chain is all but cut off by the pandemic. This was in fact that case early on, when overseas factories were shut down by

---

[19] *Morin*, 424 S.C. at 569, 819 S.E.2d at 137.
[20] S.C. Code 36-2-615(a).
[21] S.C. Code Ann. § 36-2-615, Official Comment 4. White & Summers generally endorse this view. See 1 JAMES J. WHITE, ROBERT S. SUMMERS & ROBERT A. HILLMAN, UNIFORM COMMERCIAL CODE § 4:23 at 356-57.

government order. But most factories have since reopened. The problem is now is getting goods and equipment from the overseas factory to the United States. So far there do not appear to be any reported cases on whether UCC § 2-615(a) can apply to the current supply chain mess, where delivery is usually possible but subject to delay and a "marked increase in cost," to put it mildly. There are certainly arguments to be made in favor its application.

Of course, UCC Article Two does not necessary apply to international contracts for the sale of goods. The U.S. and China are both parties to the CISG, as are many other trading nations. Article 79 provides as follows:

> A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it, or its consequences.[22]

This language seems slightly different from UCC § 2-615(a). Under the UCC, the non-occurrence of the impediment must be a "basic assumption" of the contract. But under the CISG, the impediment must be something the party could not reasonably have been expected to take into account. It seems easier to make the case that no one took into account the possibility of a ten-fold increase in freight rates, or that slots aboard container vessels would become scarce as hen's teeth, all due to a global pandemic that first reared its head early in 2020.[23] Of course, despite its wide adoption by trading nations, it remains common to disclaim the CISG in favor of some other body of trade law—often a version of UCC Article Two.[24]

---

[22] CISG Art. 79. [check CISG book at K&L?]

[23] See JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION § 432.2 at 627-28. According to Professor Honnold, a "widely but not universally shared" view is that the Article 79(1) standard "is not strict impossibility of performance, but rather such extreme difficulty in performance as amounts to impossibility from a practical (although not technical) viewpoint."

[24] See RALPH H. FOLSOM, MICHAEL WALLACE GORDON, JOHN A. SPANOGLE, JR. AND MICHAEL P. VAN ALSTINE, INTERNATIONAL BUSINESS TRANSACTIONS § 1.4 at 15 (3d ed. 2013)

Force Majeure Clauses

"*Force majeure*" is French for "superior force."[25] The phrase derives from the positive law of France, and in that sense is akin to the impracticability provisions of the UCC and CISG.[26] Given the former absence of similar codifications in common law countries, parties often inserted *force majeure* causes in contracts. Such clauses persist despite the adoption of the aforementioned codifications. To some extent, a *force majeure* clause simply duplicates the relief now available in the case of impracticability. But as a creature of contract, a *force majeure* clause can embellish that relief depending on its particular wording.

A typical *force majeure* clause will excuse a party unable to perform a contract due to an event of "force majeure." A typical contract definition might define force majeure to include

> acts of God, and the public enemy, the elements, fire, accidents, breakdowns, strikes, differences with workmen, and any other industrial, civil or public disturbance, or any act or omission beyond the control of the party having the difficulty, and any restrictions or restraints imposed by laws, orders, rules, regulations or acts of any government or governmental body or authority, civil or military….[27]

Courts are often unwilling to reallocate economic risks based on *force majeure* clauses. As the Fourth Circuit has commented, "[i]f fixed-price contracts can be avoided due to fluctuations in price, then the entire purpose of fixed-price contracts, which is to protect both the buyer and the seller from the risks of the market, is defeated."[28]

That said, *force majeure* clauses vary widely by contract. Some may be broad enough to cover commercial risks. One of the standard form contracts published by the American Institute of Architects includes something akin to a *force majeure* clause. Section 8.3 of the AIA "General

---

[25] See Viterbo v. Friedlander, 120 U.S. 707, 728, 7 S. Ct. 962, 973 (1887); Trinh v. Citibank, N.A., 850 F.2d 1164, 1170 (6th Cir. 1988).
[26] See *The Eros*, 241 F. 186, 193 (E.D.N.Y. 1916) ("the contention was that the claimant was relieved by *force majeure* under the French Code").
[27] *Langham-Hill Petroleum, Inc. v. S. Fuels Co.*, 813 F.2d 1327, 1329 n. 1 (4th Cir. 1987).
[28] Id. at 1330.

Conditions of the Contract for Construction"[29] provides that a contractor's performance time "shall be extended" when the work has been delayed by, among other things, "unusual delay in deliveries." This would seem to cover supply chain delays resulting from a lack of available shipboard capacity or a local shortage of empty containers. Every *force majeure* clause should be given a careful look to assess whether its particular terms might provide relief to the beleaguered seller or other contract party.

And some supply chain difficulties do fall within the traditional understanding of the *force majeure* clause. Early on, the COVID-19 pandemic resulted in government shutdowns of ports and other transportation infrastructure. Government action of this nature can certainly constitute a *force majeure* event. Most such shutdown orders, however, have been lifted, making it difficult to blame the current supply chain mess on government action.

Given some uncertainty in the law, the best way to deal with supply chain contingencies is to provide for them in the contract (advice that, admittedly, isn't much help to those already confronted with supply chain dilemmas). Where, for example, a contract for the sale of goods requires delivery by a certain date, the seller can insist on a clause allowing for reasonable extensions where justified by the lack of empty containers or onboard space. Such a contract can also include a price adjustment should shipping costs exceed a set amount. Indeed, a contract can state so many words that "a basic assumption of this contract is that container freight rates from Shanghai to Charleston will not exceed X dollars per container," which should at least trigger the relief contemplated by the Restatement and UCC Article Two. Some form contracts describe certain costs as "allowances," meaning that the parties agree on an estimate for some fixed cost affected performance. The allowance can then be adjusted up or down depending on the actual

---

[29] American Institute of Architects, AIA Document A201®--2017.

cost.[30] Treating freight costs as an allowance basically shifts the risk of cost increase to the other party—as well as providing an upside to the other party if freight rates go down, as they are bound to do at some point. But the fact is, the current unprecedented increases in freight costs will result in hardship to someone, regardless of how contracts are drafted. Uncertainty, whether the result of new tariffs on goods or of unforeseen supply chain contingencies, is always bad for business.

[30] See, e.g. AIA Document A201®-2017 at § 3.8.