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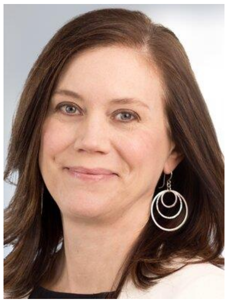
Review Shipping Terms In Light Of These 3 Global Challenges

By **Meagan Bachman, Edmund Northcott and Lily Geyer** (October 10, 2024, 6:09 PM EDT)



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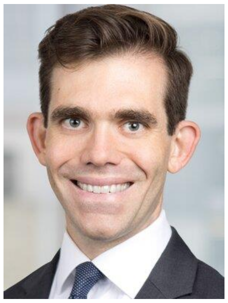

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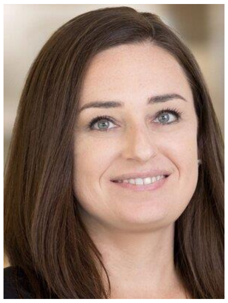

Lily Geyer

Given the geopolitical tensions in the Middle East, the threatened impact on exports worldwide arising from the recent U.S. port strike, and the ongoing consequences of climate change, it is important for parties — especially those with contracts applying Middle East and North Africa laws to projects that may be affected in the region — to understand the relevant contract provisions that may be implicated during supply chain disruptions.

Understanding and properly applying these contract provisions — such as force majeure and price adjustment provisions — as well as applicable local laws can be crucial, not only for identifying agreed allocations of the risks posed by these challenges, but also in helping parties to mitigate these risks.

Geopolitical Tensions in the Middle East

The recent escalation of conflict between Israel and regional militant groups, and the ongoing conflict in Yemen between the Houthis supported by Iran and a Saudi-led coalition of various Arab states, have exacerbated existing vulnerabilities in global shipping routes.

In response to Hamas-led attacks on Oct. 7, 2023, Israel began conducting extensive military operations targeting Hamas in Gaza, and later Hezbollah in Lebanon. It has also defended and responded to direct missile attacks from Iran.

In retaliation for these operations, the Houthis in Yemen have launched, with Iranian logistical support, attacks on commercial shipping in the Red Sea and the Gulf of Aden, which is a vital shipping route for more than $1 trillion worth of cargo per year. To date, the Houthis have targeted more than 80 merchant vessels that they claim are linked to Israel, the U.S., the U.K. or the Saudi-led coalition.

Two ships have been sunk, one vessel seized and four sailors killed. While the attacks had fallen off in recent weeks, the Houthis have promised to renew their campaign in light of the quickly escalating situation in Lebanon, where recent Israeli attacks targeting Hezbollah have included explosive devices, missiles and ground incursions.

The fighting has already affected major shipping routes through the Suez Canal — a critical chokepoint for global maritime trade. The increased military activity and potential threats to shipping lanes have caused delays, rerouting of vessels and elevated insurance premiums.

Maritime vessels operating in the Eastern Mediterranean and Red Sea regions face heightened risks as the Israel-Hamas war has transformed into a regional conflict, including potential attacks and the need for enhanced security measures. Vessels may also face further restrictions on shipping routes — if, for example, Iran moves to close the Strait of Hormuz.

All this further complicates an already strained shipping framework and global supply chain.

U.S. Port Strike

The recent U.S. port strike, and the threat of its resumption, or of other strikes like it, further complicate the global shipping landscape, and could potentially lead to further supply chain disruptions, as the affected ports handle a quarter of U.S. international trade.[1]

The International Longshoremen's Association and the U.S. Maritime Alliance were in a deadlock over wage increases, enhanced health care benefits, increased employer contributions to retirement plans, and provisions against automation. The strike by 45,000 dockworkers, which took effect on Oct. 1, halted shipments at U.S. East Coast and Gulf Coast ports.

The parties reached a tentative agreement on Oct. 3, with the union and port operators agreeing to extend their contract until Jan. 15, 2025. In the meantime, the parties agreed to a wage increase and the continued negotiation of all outstanding issues. The risk of the strike resuming remains should the parties fail to reach an agreement by Jan. 15.

Impacts of Climate Change

Climate change also can affect global shipping and trade, as illustrated by the severe drought that affected the Panama Canal for much of the past year.[2] The Panama Canal handles a significant portion of U.S. and global maritime trade.[3]

The drought led to historically low water levels, reducing the canal's throughput by millions of tons, and causing ships to be delayed. The effects of this disruption are felt not only in Panama, but also in neighboring countries and globally, with trade flows in ports from Central America to Asia, Europe and North America affected.

Supply Chain Disruptions

The combined effects of the present Middle Eastern conflicts, labor strikes by workers responsible for maintaining global shipping, and the threat of climate extremes pose a risk of significant current or future supply chain disruptions. To hedge against such potential disruptions, stakeholders should assess the immediate and long-term effects of these issues on their supply chains.

For example, short-term effects of supply chain disruptions could include delays in shipping schedules, increased costs and potential shortages of goods. Long-term effects could involve major shifts in trade routes and changes in inventory management practices.

Parties may also be well-served to review their business and project execution strategies to mitigate these disruptions, by diversifying supply chains, adjusting inventory levels and utilizing alternative transportation routes. In addition, reviews of applicable contracts to understand ongoing rights and obligations, and evaluation of risks and risk mitigation in future contracts, are also prudent.

Legal and Practical Considerations

Stakeholders can benefit from proactively addressing potential legal and operational challenges arising from the current global shipping crisis, and from having contingencies in place for potential future crises.

From a legal perspective, parties should conduct a thorough review of their existing contracts to consider if and how force majeure and price adjustment clauses may apply.

This is particularly important on international projects. Geographically-diverse contracting parties may have very different views on which events are typically caught by force majeure, and on the interpretation of the varying and potentially conflicting domestic laws that may be applicable to each contract and operational location.

Force majeure refers to unforeseeable events beyond the control of the contracting parties that prevent one or both parties from fulfilling their contractual obligations. There are specific considerations surrounding force majeure provisions under MENA laws.

Courts in MENA countries have varied interpretations of force majeure, often requiring the event to be unforeseeable, unavoidable and beyond the control of the parties. Unless excluded by the relevant contract, typical force majeure events recognized in the region include natural disasters, war, terrorism and government actions.

Potentially affected parties should be cognizant of the impact relevant local laws may have on their contracts. Certain civil codes in the MENA region provide that where an obligation becomes impossible to perform for reasons beyond a party's control, the corresponding obligation ceases and the contract is terminated.[4] Others provide for a right to renegotiate the affected obligation.[5]

It is also common under such civil codes for judges to have the power to amend contractual provisions, to reduce an excessively burdensome obligation and avoid exorbitant loss flowing from unforeseen exceptional circumstances.[6] The position in each jurisdiction will vary, including what the relevant test is for determining applicability, foreseeability and nature of the hardship suffered.[7]

A review of local law can be critical to understanding which statutory provisions may apply, including identification of mandatory provisions of law that void any contract provisions to the contrary. This is particularly the case for contracting parties who are traditionally rooted in common law jurisdictions who may not be as familiar with civil law practices.

Additionally, existing price adjustment clauses can provide a mechanism for parties to renegotiate terms in response to significant changes in circumstances, such as changes in market conditions or when new costs occur, to ensure that contracts remain fair and viable. As above, the legal framework and enforceability of such clauses in MENA countries may differ in comparison to other regions.

MENA jurisdictions may have specific legal frameworks governing price adjustments, often requiring clear evidence of the change in circumstances and its impact on the contract. Some examples of circumstances warranting price adjustments include significant increases in raw material costs, changes in currency exchange rates, and new regulatory requirements, i.e., changes in law.

When considering the application of price adjustment provisions in light of the current global shipping challenges and their impacts, parties should carefully evaluate the triggers for price adjustments, the mechanisms for calculating adjustments, and what the options are for dispute resolution if there are differences between the parties as to whether, how and what price adjustments are to be permitted under the circumstances.

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Crowell & Moring partners Rob Hager and Michael Guiffre, and associate Leslie Castello, contributed to this article.

[1] See Alexander H. Tullo, Strike closes US ports, Chemical and Engineering News (Oct. 1, 2024), https://cen.acs.org/business/economy/Strike-closes-US-ports/102/i31#:~:text=The%20Conference%20Board%2C%20an%20economic,economy%20%24540%20million%20per%20day.

[2] See Josh Eiermann, Panama Canal traffic to increase as drought conditions ease, U.S. Energy Information Administration (June 27, 2024), https://www.eia.gov/todayinenergy/detail.php?id=62408.

[3] See Serkan Arslanalp, Robin Koepke, Alessandra Sozzi, Jasper Verschuur, Climate Change is Disrupting Global Trade, IMF Blog (Nov. 15, 2023), https://www.imf.org/en/Blogs/Articles/2023/11/15/climate-change-is-disrupting-global-trade.

[4] See, e.g., Qatar Law No. (22) of 2004 (Regarding Promulgating the Civil Code 22/2004), June 30, 2004, Art. 188. This is also the position for construction contracts, pursuant to Article 704 of the Qatar Civil Code, which deems the contract terminated in the event the contract becomes impossible to perform for reasons not incumbent on the parties.

[5] See, e.g., Kingdom of Saudi Arabia Civil Transactions Law, issued by Royal Decree No. M/191, June 18, 2023, art. 97; Federal Law No. 5 (Civil Transactions Law of the United Arab Emirates States), as amended by Federal Law No. 1, Feb. 14, 1987, art. 249.

[6] See, e.g., Civil Code, art. 171(2) (Qatar).

[7] For example, under Qatar law (Article 171) the test for the nature of hardship is "excessively onerous," whereas under U.A.E. law (Article 273) it must be "impossible."