



*Note: originally presented orally and visually.
Additional data and material added for coherence
(i.e., we prioritized comprehensiveness over tidiness.)*

Shock-proofing Supply Chain Contracts:

Vaccinating Your Supply Chain Contracts
against Global Crises



Topics

Shattering Paradigms:

The fragility of supply chain contracts in the current environment.

Arming your Documents:

Contract clauses you must include.

Call the Hessians!:

Utilize Internal Audit for assistance.



The Impact of COVID on Supply Chains (WEF)

On June 22, 2020, the World Economic Forum released a report about The Ongoing Impact of COVID-19 on Global Supply Chains. This report offered three primary takeaways:

- 1. Companies should analyze supply chains now to mitigate against future disruptions.**
- 2. Trade wars, global politics, and national policies will influence the future of supply chain structures.**
- 3. Investment in technology and considerations on sustainability in the supply chain will be key.**





But How Do You Know What To Address?

“There are known knowns; there are things we know we know.

“We also know there are known unknowns; that is to say we know there are some things we do not know.

“But there are also unknown unknowns—the ones we don't know we don't know.”

- Donald Rumsfeld





Contracts: The Status Quo Ante

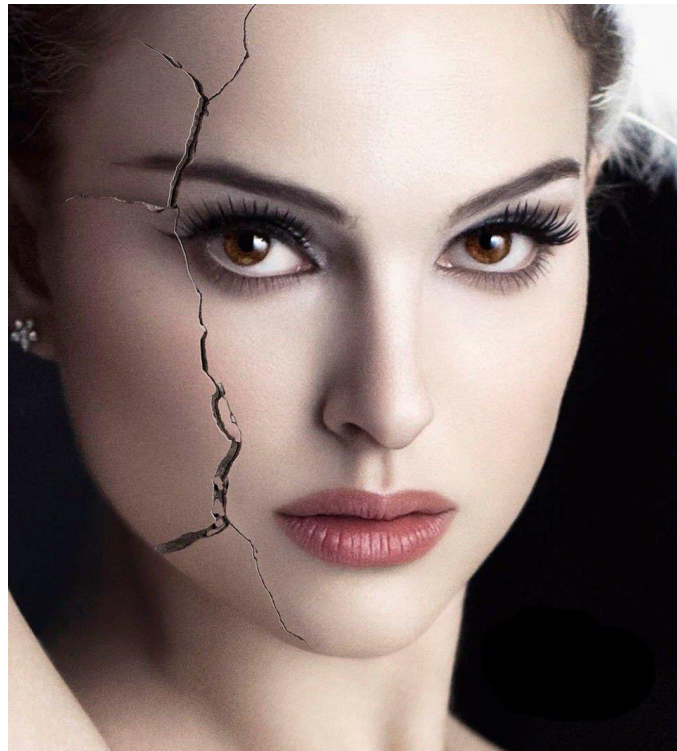
YOUR CONTRACTS MAY NOT BE PROHYLACTIC OR FIT-FOR-PURPOSE...

(...and you may only find this out at negotiation / mediation / arbitration / litigation, or during accounting or compliance reviews.)

- 1. Known Knowns:** today's contracts have unfortunate gaps.
 - Sometimes the wrong contract form is used (e.g., a Master Purchase Agreement for a sales representative engagement.)
 - Shifting between civil law countries and common law countries can create significant gaps.
- 2. Known Unknowns:** yesterday's contracts are not prepared for today's problems.
 - Contracts are designed to handle known problems if/when they occur. They are based on past precedent.
 - For future engagements, companies often use templates developed years in the past.
 - If no problems occur, they are often simply extended or amended (even for certain higher-risk counterparties)
- 3. Unknown Unknowns:** Black Swans...



“Black Swans”? Like...



Black Swan (2010)

➤ “Acts of terrorism” in Force Majeure clauses [likely generated by the 9/11 terrorist attack] ⁽¹⁾

➤ “Pandemics” in Force Majeure clauses [due to COVID-19]? ⁽²⁾

- (1) The World Trade Center attacks were not the first acts of terrorism, nor the most devastating. They did, however, create a contractual inflection point.
- (2) The Corona Virus is neither the first, nor the most devastating, pandemic of modern times.
 - The 1918 Spanish Flu, at 50M deaths, holds the record for “most devastating”.
 - In modern times, the world has suffered the 1957 H2N2 pandemic, the 1968 H3N2 pandemic, and – more recently – SARS, MERS, Swine Flu, and others.



The Current Environment – Risks and Solutions*

- ✓ Force Majeure
- ✓ Governing Law / Jurisdiction
- ✓ Financial Feasibility of Counterparties
- ✓ Shipping Costs / INCO Terms
- ✓ Data Privacy / GDPR
- ✓ Trade Sanctions / Restrictions
- ✓ Right-to-Audit

**SHOCK-PROOF
YOUR SUPPLY CHAINS**

** Your preferred strategy and contract language will depend on whether you are buyer or seller.*



Force Majeure (1): Definition.

(As understood under common law. Civil law jurisdictions may incorporate the concept automatically pursuant to applicable Code.)

- **Topic**: an event which is outside the reasonable control of a party and which prevents that party from performing its obligations under a contract, e.g.,
 - Political events (e.g., war, national strike, acts of terrorism)
 - Non-political events (e.g., hurricanes, floods)
- **Goal**: contractually determine* under what circumstances a party is relieved from performing the obligation affected for the duration and to the extent affected (and any compensation related thereto).
- **Consequences**: contractually unique (but could include suspension, voiding of contract, release from obligations, etc.)

* There are less commonly-enforced common law doctrines of, e.g., frustration and impossibility, and civil code definitions of a similar nature, all of which are beyond this slide deck's focus, and most of which are disregarded by courts if the contract contains a Force Majeure clause.



Force Majeure (2): Elements, Generally.

1. **Inability to Control**. Market language seems to converge on events, “beyond a Party’s reasonable efforts to control”, and that make continued performance impossible.
2. **Unforeseeability**. Some jurisdictions (or contracts) require the event to be “unforeseeable” to trigger the clause.
 - *England, Texas: unless stated otherwise, specific events do not need to be foreseeable, but events not specifically listed require this element.*
 - *New York: unless stated otherwise, all events must be unforeseeable to qualify.*
3. **“Catch-all”**. Courts disfavor contract disruption: unless mentioned with specificity, they will often construe “catch-all” language to be limited to events *similar to* those listed with specificity.



Force Majeure (3): so...COVID?

It is rare to see “epidemic/pandemic” in today’s (and yesterday’s) contracts.
It will likely be less rare in the future.

Questions for your business:

1. What’s the difference?

- In colloquial terms, “epidemic” is more localized while “pandemic” is international. (It is unclear if courts will focus on this distinction.)

2. Does its inclusion help or hurt you? (i.e., are expansive or limiting FM clauses more advantageous to you?) Your posture may depend on, e.g., whether you are supplier or customer.

3. Recommendations:

- ✓ **Supply Chain Shock Treatment:**
 - Assess if crucial supply chain contracts do not have appropriate Force Majeure clauses for your business.
 - Use Internal Audit to help you with this assessment.
- ✓ **Prepare for defense of your Force Majeure posture.**



Governing Law / Jurisdiction

To some of us, these clauses are fundamental. However, there are risks:

- Insularity. Domestically-focused companies may sometimes omit such language in contractual templates.
- Variation in Legal System. Consider the risks involved in shifting between Civil Law and Common Law:
 - Civil to common – sometimes, code-generated doctrine (e.g., force majeure) is left out.
 - Common to civil – sometimes, common law doctrine will be unenforceable or even contrary to applicable civil law provisions.
- Variability in Local Enforcement. Some jurisdictions consider the positions of other jurisdictions to be against public policy and therefore unenforceable. (e.g., non-competes in CA and TX)



What do they have in common?

(As of end-of-half 2020, over 110 businesses have declared bankruptcy citing the pandemic as the cause.)





Financial Feasibility of Counterparties

How to sensitize yourself to financial risks of counterparties by monitoring and controlling for insolvency risk:

1. Pre-engagement due diligence:
 - For your most crucial counterparties, do some digging. Use resources - such as Kreller, SEC.gov, local tax filings, or other solutions - to confirm financial viability.
2. Continuing engagement monitoring:
 - Monitor your major counterparties' financial viability.
3. Clauses to protect against loss:
 - Liquidated damages clause – in the event of a failure to meet contractual obligations, you now have calibrated damages (theoretically) calculated to cover the costs of prompt substitution (if possible).
 - Business continuity / disasters – steps for mitigation.
4. Insurance considerations – consider, e.g., monitoring solvency ratios.



Shipping Risks and Costs

(or, have you ever cancelled a purchase after you realized how much shipping added to the total?)

Topic: determine the counterparty accepting costs for shipping and risk of damage/loss.

Goal: determine which counterparty takes the risk.

Consequences: contractually unique:

- Generally, contracts do not excuse performance if performance becomes more expensive. (Sometimes, prices can be modified due to regulatory change or otherwise.)
- Jurisdictions and governing law matter! *Without contractual specificity:*
 - Transfer of title to goods differs from jurisdiction to jurisdiction.
 - Passing of risk of loss or damage is also subject to jurisdiction.

God Save the INCOTerms! (1)



Hypothetical Problems:

- A cargo ship sinks at sea. Who (i.e., the buyer or seller) will be ultimately responsible for paying for insurance and/or absorbing loss?
- A shipper gets fined at a border crossing for illegal imports. Who (i.e., the manufacturer or customer) had title at the point of importation?

Potential Solution: internationally-recognized commercial terms developed by the ICC (International Chamber of Commerce) and used by businesses to specify whether buyer or seller is responsible for each task in the sale and delivery of goods. They cover which party is liable for:

- Duties
- Costs
- Risks



God Save the INCOTerms! (2)

Examples:

EXW (“Ex Works”):

upon pickup (at seller’s location), buyer takes possession and is liable for all costs thereafter.

CPT (“Carriage Paid To”):

liability for loss or damage transfers upon initiation of shipment. Seller pays export licenses and shipping costs, but is not liable for loss, damage, or import licenses.

DDP (“Delivered Duty Paid”):

liability transfers upon arrival to buyer’s location in satisfactory condition. seller is responsible for all costs until arrival.



Data Privacy and the (defunct) Privacy Shield

Topic: Until July 16, 2020, companies adhering to the EU-US Privacy Shield Framework had a legal basis for trans-Atlantic information transfer. Now, contracts that depend on the Privacy Shield are relying on an unlawful defense.

Goal: Avoid prosecution by various data privacy enforcement agencies.

Consequences: Companies should find alternatives (e.g., Standard Contractual Clauses (“SCC”s), explicit consent, legal exceptions, or binding corporate rules). SCCs often remain a preferred solution with corporate counterparties. As a result, it would be prudent for companies – particularly those with significant data privacy-related risk – to review crucial third party contracts for SCCs.



Trade Sanctions / Restrictions

Topic: a governmental order, law or action (*typically after the date of the agreement*) that materially impacts performance. (e.g., sanctions, boycotts, onerous licensing requirements) [*Typically in a Force Majeure clause*]

Goal: determine which counterparty takes the risk.

Consequences: contractually unique. If not included, non-performance likely leads to breach.

In addition to Force Majeure-type considerations, Triggering Questions:

1. Did it occur prior or subsequent to the execution of the agreement?
2. Is the party still able to perform (i.e., is it a prohibitive impediment, or does it merely generate cost and delay)?
3. If performance is hindered or blocked, who incurs the additional cost?



Right-to-Audit

- Government enforcement agencies expect to see it.
- Standard commercial practice is to include it.

If you've got to have it, what should it cover?

- Liability for compliance-related risks (e.g., bribes, involvement of a sanctioned counterparty)
- “Mere” fraud (invoice padding, overbilling, outsourcing major work to subpar subcontractors, etc.).
- Review of margins?



Internal Audit (IA) – your internal mercenaries

- IA often reviews compliance with internal policies and applicable laws.
 - IA is typically used for, e.g., compliance audits of higher risk counterparties, financial audits of expense reports, or QHSE audits of applicable regulations.
- IA is also perfectly positioned to consider business continuity risks through supply chain contracts.
 - IA can look through documents to find contractual gaps and liabilities of your most critical counterparties and thereby assess risk.

This is where, dear Reader, I would discuss some case studies. Contact me to learn more.

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