



# Supply Chain Reaction:

## Strategies for Mitigating Supply Chain Risk in the Wake of the Pandemic

*By Emily K. Bardon and Steven S. Poindexter*

September 22, 2022

# Meet Our Presenters



Emily K. Bardon  
[ebardon@lewisrice.com](mailto:ebardon@lewisrice.com)  
314.444.7706



Steven S. Poindexter  
[spoindexter@lewisrice.com](mailto:spoindexter@lewisrice.com)  
314.444.1327

**"The supply chain stuff is really tricky."**

**– Elon Musk, 2016**

# The Supply Chain

- Network of all the individuals, organizations, resources and technology involved in the creation and sale of a product.
- Includes everything from the delivery of raw materials to the delivery of the end product to the end user.



# ***Best Practices in Supply Chain Management***

# Diversifying Supplier Base

- A supplier wants all of your eggs in its basket
  - Gives you purchasing power but concentrates your risk
- Have a Plan B and a Plan C

# Conduct Thorough Diligence on New Suppliers

- Typically choose suppliers based on cost and quality
- Consider using additional metrics:
  - Use of technology
  - Financial health
  - Market share
  - Employee satisfaction
  - Current litigation

# Invest in Supply Chain Management Technology

- Automation of business processes in operations such as warehousing, transportation and production
- Data reporting and analytics
- Collaboration tools that create environments where stakeholders can share information across the enterprise



# Know the Chain

- Understand the entire process, including the procurement of the raw materials, transportation and freight, inventory management, and how the product ultimately gets to the end customer
- Cannot plan strategically about a process that is in a black box



## ***Contracting Strategies – Creating Flexibility***

# Exceptions to Exclusivity

- Inability to supply
- Breaches
  - Alternative to termination
- Excuse minimum purchaser obligations

# Price Adjustment (Escalation) Clause

- Purpose: Protect a party (typically seller) from changes in its costs to supply goods or services.
- Most Common Indexes: Consumer Price Index (CPI) or Producer Price Index (PPI)

# Price Adjustment (Escalation) Clause (cont'd.)

- Guidelines for Developing Price Adjustment Clauses
  - State the base price subject to adjustment
  - Select an appropriate index or indexes, then clearly identify it and cite source
  - State the frequency of price adjustment
  - Provide fallbacks for missing or discontinued data
  - Define the mechanics of the price adjustment, including any limits

# Excuses for Failure to Perform (or Delay) Force Majeure

- Purpose: addresses the risk of the occurrence of certain events that are outside the control of a party to a contract (a “force majeure event”) that prevent the impacted party from performing a contract in whole or in part
- Contractual creation: drafting is key and specific terms in the contract will govern
  - Applies to one or both parties?
  - Define force majeure event
    - catchall can be risky
    - exclusions

# Excuses for Failure to Perform (or Delay) Force Majeure (cont'd)

- Effect of the force majeure excuses or suspends performance
- Procedure (notice, mitigation) required to benefit from the force majeure clause
- Termination rights (and if included, whether mutual)
- Whether one party can seek an alternative source during an ongoing force majeure (and if so that it gets credit for minimum order or minimum purchase obligations)
- Whether the term of the contract is extended during the continuance of the force majeure event

# What if there is no force majeure?

- Obstacle to performance?
  - Doctrine of Impossibility
  - Doctrine of Commercial Impracticability
- Failure of consideration?
  - Doctrine of Commercial Frustration



# Impossibility

- Elements
  - performance made objectively impossible
  - by an unexpected contingency which the contract parties assumed the nonexistence of
- Examples
  - the subject matter of the agreement is destroyed
  - a party's means of performance is prevented
- Foreseeability is an impediment to impossibility excusing performance

# Impracticability

- Common Law Elements
  - an unexpected event or circumstance
  - makes seller's performance commercially senseless due to excessive and unreasonable cost to perform
- UCC Section 2-615(a)
  - Commercially impracticable
  - Due to either:
    - Unforeseen supervening circumstances not within the parties' contemplation at the time of contracting (nonoccurrence was a basic assumption)
    - Good faith compliance with an applicable domestic or foreign government regulation or order
  - Seller did not assume risk

# Frustration

- Frustration can excuse performance only if:
  - The impacted party seeking to be excused can no longer accomplish its purpose for the transaction.
  - Both parties knew of the impacted party's principal purpose for entering into the contract.
  - An unexpected supervening event (not caused by the impacted party's own fault) caused the frustration.
- Lack of foreseeability is initial threshold.

# Termination Rights

- Termination may be extreme
- Add leverage by altering other terms in lieu of termination
  - Products
  - Exclusivity
  - Territory
  - Minimum purchase obligations
- Ongoing force majeure



## ***Contracting Strategies – Managing Risk***

# Price Guarantees

“All prices are firm and are not subject to increase for any reason, including changes in market conditions, increases in raw material, component, labor, or overhead costs or because of labor disruptions or fluctuations in production volumes.”

# Delivery Commitments

- “**Supplier shall ship the Products** ordered by Company **to arrive** at the designated location(s) on the date(s) designated by Company in the applicable Purchase Order. Time, quantity, and delivery to the designated location(s) are of the essence under this Agreement.”
- “Supplier shall **use commercially reasonable efforts to** ship the Products ordered by Company **so that they** arrive at the designated location(s) on the date(s) designated by Company in the applicable Purchase Order. Time, quantity, and delivery to the designated location(s) are of the essence under this Agreement; **provided, however, that Supplier shall not be liable for any missed delivery dates to the extent such failure was due to shipper or carrier delays, freight delays, port closures or similar events beyond the control of Supplier.**”

## Delivery Commitments (cont'd)

- “If **Supplier does not timely deliver the Products**, Company may, in Company’s sole discretion and at Supplier’s sole cost and expense, (a) approve a revised delivery date, (b) require expedited or premium shipment, or (c) cancel the applicable Purchase Order.”
- “If **the Products are not delivered on the requested delivery date due to the negligence or willful misconduct of Supplier**, Company may, in Company’s sole discretion and at Supplier’s sole cost and expense, (a) approve a revised delivery date, (b) require expedited or premium shipment, or (c) cancel the applicable Purchase Order.”
- What are the remedies for failure to deliver?



# Audit Rights

- Audit rights allow a party to access and inspect the other party's books and records.
- Inspection rights allow a party to access and inspect the other party's facilities.
- Enables a party to better enforce its rights regarding supplier and subsupplier requirements.
  - Obtain information about "sole source" subsuppliers that provide critical materials
  - Confirm quality and timeliness

# Insurance

- Business Interruption Insurance
  - Covers losses due to a business stoppage or slowdown caused by direct physical loss or damage to the insured property.
  - Contingent Business Interruption Insurance
    - If business is lost due to physical loss or damage at the property of the company's suppliers
    - E.g., microchip shortage due to the deep freeze in Texas that forced closure of several microchip factories.

# Insurance (cont'd)

- Supply Chain Insurance

- Covers losses resulting from disruption in a company's supply chain
- Physical loss at a covered location is not required to trigger coverage
  - E.g., natural disasters, labor issues, political upheaval, closure of roads or bridges, public health emergencies, etc.
- May be limited to disruptions in receipt of certain products from named suppliers
  - Inquire about multitier coverage

# Indemnification and Limitation of Liability

- Indemnity provisions should interlock up and down the supply chain
- Confirm that limitations of liability do not override or create inconsistencies with the indemnity obligations
  - Waivers of consequential damages
  - Liability caps



Questions?

# Contact us:



Emily K. Bardon  
[ebardon@lewisrice.com](mailto:ebardon@lewisrice.com)  
314.444.7706



Steven S. Poindexter  
[spoindexter@lewisrice.com](mailto:spoindexter@lewisrice.com)  
314.444.1327



Thank you!