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# Global Supply Chain Agreements: Force Majeure, Indemnification, Warranty, Termination, and Other Key Provisions

Allocating and Mitigating Risk, Addressing Disruption and Nonperformance

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TUESDAY, NOVEMBER 24, 2020

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Today's faculty features:

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# **Global Supply Chain Agreements: Force Majeure, Indemnification, Warranty, Termination, and Other Key Provisions**

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November 24, 2020

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# Topics

- **Fundamentals of Supply Chain Contracting**
- **Force Majeure Provisions**
- **Contract Theories of “Frustration” and “Impossibility”**
- **Commercial Impracticability Under The UCC**
- **The Adjustment of Payment Terms**
- **Indemnification Provisions**
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# Topics

## ✓ **Fundamentals of Supply Chain Contracting**

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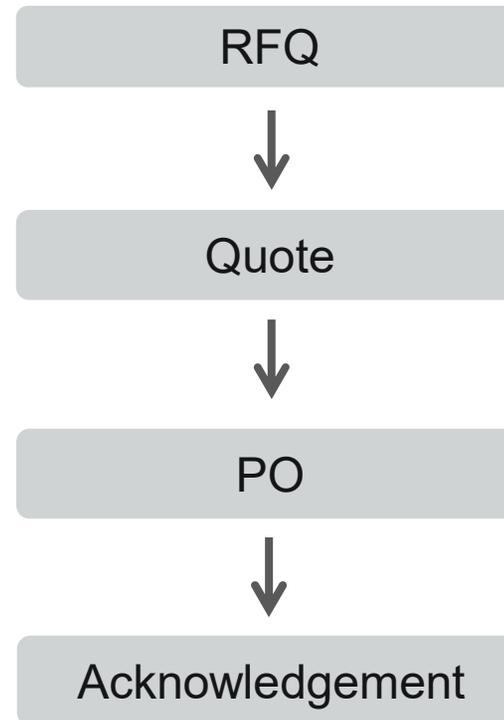
# Fundamentals of Supply Chain Contracting

- What is a Contract?
  - An agreement creating obligations that are enforceable or otherwise recognizable by law
- Requires
  - Parties competent to contract
  - Proper subject matter
  - “Consideration”
    - Legal detriment
  - Mutuality of agreement



# Fundamentals of Supply Chain Contracting

- Contract Formation
- Common Documents
  - Request for Quotation
  - Quotation
  - Purchase Order
  - Acknowledgment
  - LTA
- “Battle of the Forms”
  - UCC 2-207
- Service Contracts
  - Statement of Work



# Topics

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# Force Majeure

- Purpose
  - Force Majeure clauses (sometimes called “Excusable Delay” clauses) typically identify certain scenarios outside the control of the contracting parties that would excuse delayed performance or non-performance
- Applicability
  - While these clauses may seem to provide broad coverage, they are often interpreted more narrowly
  - The exact scope of coverage will depend on the language of the clause, the interpretation of the adjudicator, and the laws of the applicable jurisdiction

# Force Majeure

- Common Law vs Civil Law
  - Understanding the distinctions between common law interpretation (e.g., US, UK, Canada, Australia), civil law interpretation (e.g., France, Germany), and mixed systems (e.g., China and the UAE) are particularly important for international agreements

# Force Majeure

- Civil Law Interpretations

- Under the French Civil Code, which is influential across many civil law systems, the applicability of a force majeure clause depends on three factors:
  - Was the force majeure event beyond the control of the affected party?
  - Could the relevant event reasonably have been foreseen at the time the contract was executed?
  - Could the effects of such event be avoided by appropriate mitigation measures?
- Take away: a major event that causes inconvenience or additional costs of performance in and of itself may NOT be enough to trigger a force majeure clause in a civil law jurisdiction

# Force Majeure

- Common Law Interpretations
  - Interpretation will be rooted in contract law principles.
  - Most common law courts will consider whether an event is expressly stated in the clause, as well as the nature of the performance required under the contract. If, for example, the contract allows the supplier to supply material from any source, the unavailability of a particular source is likely not enough for a successful force majeure defense.
  - Causation is a key consideration:
    - Was the event the direct reason for delayed performance or non-performance, or was delayed performance or non-performance caused by a chain of events, of which the event was merely one component.
  - Example: while a force majeure clause might reference an pandemic, the actual cause of non-performance could be a government ordered quarantine.

# Force Majeure

## ■ Example Provision:

- “Force Majeure” shall mean any event or condition, not existing as of the date of acknowledgment of this Agreement, not reasonably foreseeable as of such date and not reasonably within the control of either Party, which prevents in whole or in material part the performance by the Parties of its obligations hereunder or which renders the performance of such obligations so difficult or costly as to make such performance commercially unreasonable. Without limiting the foregoing, the following shall constitute events or conditions of Force Majeure: acts of State or governmental action, orders, legislation, regulations, restrictions, priorities or rationing, riots, disturbance, war (declared or undeclared), strikes, lockouts, slowdowns, prolonged shortage of energy supplies, interruption of transportation, embargo, prohibition of import or export of goods covered by this agreement, and epidemics, fire, flood, hurricane, typhoon, earthquake, lightning, and explosion. If by any of the above-mentioned causes, an allocation of supplies must be made, the Parties hereby agree that such allocation will be fairly made. It is in particular expressly agreed that any refusal or failure of any governmental authority to grant any export license legally required for the fulfillment by the Seller of its obligations hereunder shall constitute an event of Force Majeure, provided said refusal or failure is not due to the fault or negligence of the Seller.”
- Source: Alternative and Optional Provisions—Force Majeure, 2 Going Global § 22:63

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# Contract Theories of “Frustration” and “Impossibility”

- Additional Contract Defenses
  - Force Majeure clauses are not always available, but additional defenses can potentially be found in the doctrines of frustration and impossibility (or impracticability)
  - These legal theories are rooted in the common law of contracts, but are often also codified into statutory or regulatory law
  - The exact interpretations will vary between jurisdictions

# Contract Theories of “Frustration” and “Impossibility”

- Frustration = when the purpose of the contract cannot be achieved. Generally applicable when:
  - an event substantially frustrates a party's principal purpose;
  - the event was not reasonably foreseeable;
  - the event was not the fault of the party asserting the defense; and
  - the party did not assume a greater obligation or risk than necessary.

# Contract Theories of “Frustration” and “Impossibility”

- Impossibility = modern interpretation is not true impossibility, but rather impracticability. Generally applicable when:
  - an event makes performance of the contract impracticable;
  - the event was not reasonably foreseeable;
  - the impracticability was not the fault of the party asserting the defense; and
  - the party did not assume a greater obligation or risk than necessary.

# Contract Theories of “Frustration” and “Impossibility”

- Hypothetical – Frustration Vs. Impracticability
  - Bart requires a shipper for his widgets. Bart and Art enter into an agreement, pursuant to which Art will pick up and deliver the Bart’s widgets in exchange for \$10,000.
  - Scenario 1 (Frustration) - Bart’s widget plant is shut down and he has no items to sell, thus the purpose of the contract cannot be achieved. The purpose of the contract is frustrated.
  - Scenario 2 (Impracticability) - The state has issued an ordinance stipulating that truck drivers may not ship widgets. It would be impractical, if not impossible, for Art to fulfil his obligations under the contract while complying with the ordinance.

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# Commercial Impracticability Under The UCC

- The Uniform Commercial Code
- 2-615. Excuse by Failure of Presupposed Conditions
  - Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:
  - (a) Delay in delivery or non-delivery in whole or in part by a seller who complies with paragraphs (b) and (c) 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 non-occurrence 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.
  - (b) Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, he must allocate production and deliveries among his customers but may at his option include regular customers not then under contract as well as his own requirements for further manufacture. He may so allocate in any manner which is fair and reasonable.
  - (c) The seller must notify the buyer seasonably that there will be delay or non-delivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

# Commercial Impracticability Under The UCC

- Key Considerations
  - Must give “seasonable” notice
  - Must be risk that is not assigned to either party under the contract
  - “We are losing money on this part” is not sufficient
  - Obligation to make “fair and reasonable” allocation of supply

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# The Adjustment of Payment Terms

- Payment Terms – Existing Contracts
  - Despite the severity of COVID-19, existing payment terms will likely be inflexible
  - However, utilization of force majeure provisions or, in the alternative, the frustration or impossibility doctrines, could shield sellers from penalties for delayed performance or non-performance that are a result of COVID-19
    - BUT – increased cost alone generally does not qualify under any doctrine

# The Adjustment of Payment Terms

- Payment Terms – Contracts under Negotiation
  - Consider using flexible payment terms while the spread and impact of COVID-19 are ongoing
    - Seek advance payment wherever possible
    - For service providers, conditioning payment on the arrival and availability of personnel overseas can be helpful
  - Documentary letters of credit provide a useful payment framework amidst COVID-19

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# Indemnification Provisions

- Indemnification Provisions
  - Require one party to reimburse the other party for a loss
  - While often tied to breaches of a contractual obligation, a breach is not necessary to trigger indemnity
  - Can be in addition to any remedies that exist for breach
    - Double recovery not permitted
  - Often covers costs that may not be recoverable under a standard breach claim, such as attorney fees

# Indemnification Provisions

- Key Considerations
  - Mutual or one-sided?
  - Nexus
    - Need to show defect or other culpability
  - Notice and opportunity to defend
    - Buyer's obligation to give notice under UCC 2-607
  - Obligation to cooperate
  - Approval of settlement

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# Warranty

- What is a Warranty?
  - Contractual promises that the seller makes concerning the goods
  - Can be express or implied



# Warranty

- Express Warranties – UCC 2-313(1)
  - Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise
  - Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description
  - Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model

# Warranty

- Implied Warranty of Merchantability – UCC 2-314
  - Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.
  - Goods to be merchantable must be at least such as
    - pass without objection in the trade under the contract description; and
    - in the case of fungible goods, are of fair average quality within the description; and
    - are fit for the ordinary purposes for which such goods are used; and
    - run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
    - are adequately contained, packaged, and labeled as the agreement may require; and
    - conform to the promise or affirmations of fact made on the container or label if any.

# Warranty

- Implied Warranty of Fitness for Particular Purpose – UCC 2-315
  - Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose

# Warranty

- Scope of Warranty
  - Absent agreement to the contrary, a seller’s warranty to its customer includes all subcomponents
- Disclaimers of Warranties
  - Implied warranties may be disclaimed if language is “conspicuous”
  - Cannot disclaim an express warranty
    - But - Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other

# Warranty

- Warranty Vs. Design Responsibility
  - Integration
  - Software vs. hardware
  - Testing/validation

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# Termination

- Termination for Breach
  - Addressed in the contract?
  - Cure period?
  - Requirement to give notice
  - Evidence
- Contractual Right of Early Termination
  - Triggers
    - Example – change in control provision
  - Notice requirements



# Termination

- Common termination issues
  - What is the Contract?
    - Battle of the forms issues
    - Amendments/modifications
    - Course of dealing, waiver
    - Expiration/renewal provisions
  - Intellectual property
  - Exit agreement
  - Transition



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# Other Key Provisions

- Quantity

- Under the UCC, the only term that must appear in the written contract is the quantity
- Without a written quantity term, the contract cannot be enforced to require any additional sales or purchase
- Requirements/output contracts

- Duration

- Contracts of indefinite duration
- A bad contract that you are locked into for the long-term can have serious consequences for the health and viability of a company
- Parties need to make sure they fully understand and agree on the duration of the contract, including termination and renewal provisions

# Other Key Provisions

- Choice of Forum/Law
  - Can mean the difference between having no meaningful remedy, and “winning the war” without having to litigate
  - Arbitration vs litigation
    - International considerations
- Data Security
  - Impose obligations for parties to protect its computer networks
  - Notify of any breach
  - Responsibility for payment fraud

# Other Key Provisions

- Limited Remedy – UCC 2-719
  - Repair or replace
  - Failure of essential purpose
- Limitation on Damages – UCC 2-719
  - Consequential, indirect – UCC 2-719(3)
  - Damage caps

# Other Key Provisions

- What Terms and Conditions Apply?
  - Other documents that may be incorporated?
  - Parties cannot fully understand their rights and obligations under a contract without understanding the documents that make up the contract
  - Documents, such as terms and conditions, supplier manuals, and other policies may be incorporated by reference
  - Integration clauses
  - “Battle of the forms”

# Thank You!

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