

## Supply Chain Litigation: Mitigating Risks via Contracts

Drafting Force Majeure Reps and Warranties and Foreseeability Provisions;  
Seeking Injunctive Relief

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TUESDAY, MARCH 15, 2022

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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# Supply Chain Disruptions: Shortages, Risk Mitigation and Litigation Strategies

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Vanessa L. Miller, Partner, Foley & Lardner LLP

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## Vanessa L. Miller

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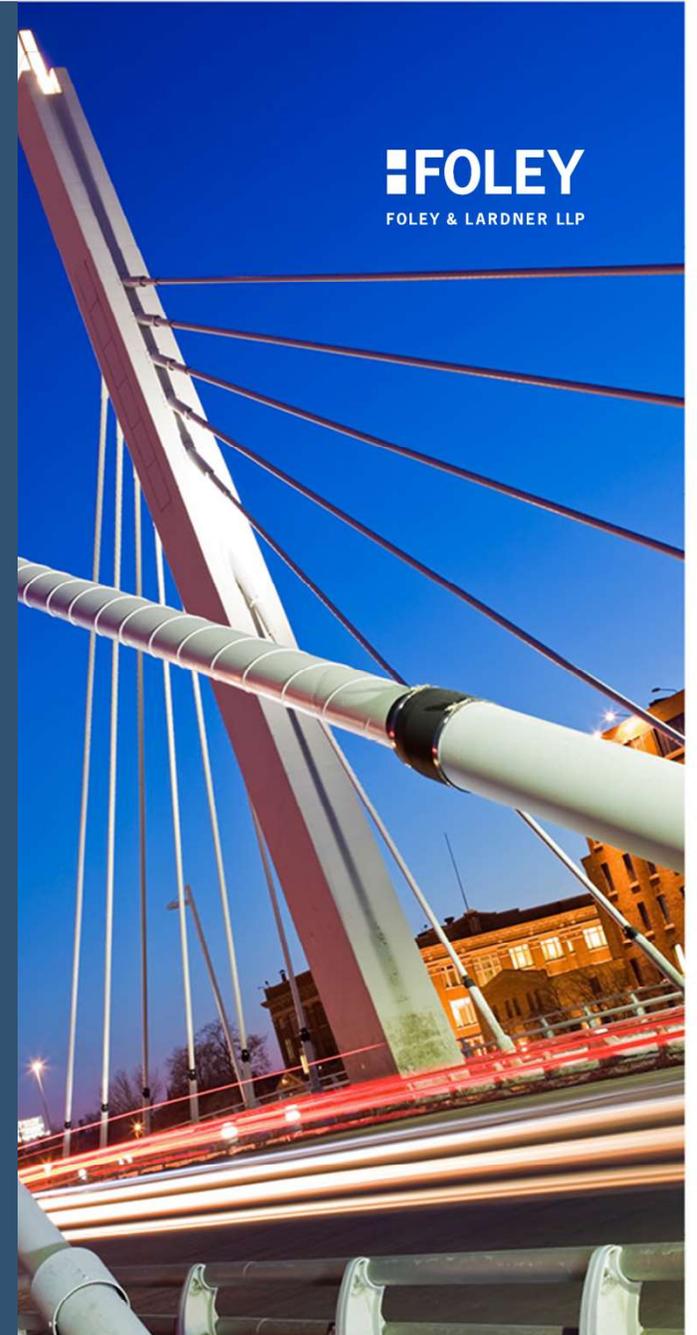
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# SUPPLY CHAIN DISRUPTIONS

## Supply Chain Shortages

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# Microchip/Semiconductor Example

## Q1-Q2 2020 = COVID Ripple Effect

- Vehicle manufacturers dramatically slash their orders
- Tier 1 suppliers then decrease their orders
- Chip vendors place orders to TSMC
  - Meanwhile, working from home has increased demand for electronics that also contain chips
  - TSMC at max capacity

## Q3-Q4 2020

- Vehicle manufacturers increase their orders to Tier 1 suppliers
- Tier 1 suppliers increase orders to chip vendors
- Chip vendors do not have enough parts to fill orders
  - Lead-time increases to 6+ months
  - Ex. Orders to TSMC placed in Nov. 2020 will not be delivered until Sep. 2021

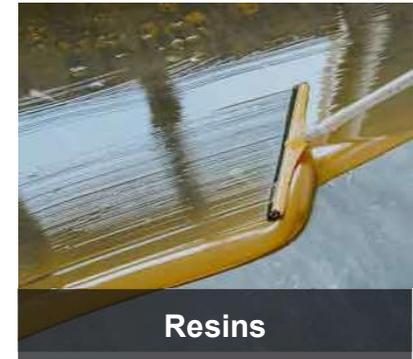
## Q1 2021

- Car plants shutting down across the globe
- Earthquake hits Renesas in Japan
- Texas storms impact chip plants
- Drought in Taiwan threatens TSMC
- Fire in Renesas
- Ongoing shipping container shortages
- Suez Canal blockage

## Q2 2021→

- Peak of semiconductor shortage but will continue into 2022
- “Toilet Paper Phenomenon” – artificially inflated demand that prolongs shortage

# Examples Of Other Supply Chain Shortages



# “But I’m Not a Manufacturer...”

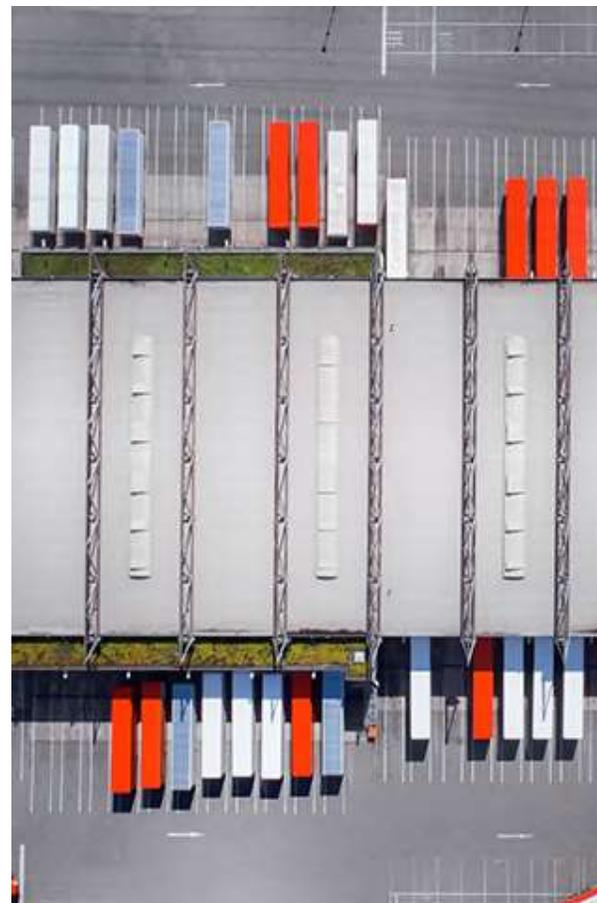
**BOSTON  
BUSINESS JOURNAL**

***'I've never seen this before':  
State Lottery hit by supply chain woes***



# Labor Shortages

- Lack of labor is the first problem in the supply chain
- Demand for workers exceeds applicants
- Skills gap
- Local mandates and COVID outbreaks
- Increased incentives and bonuses likely necessary



# Freight Delays and Issues

- Massive freight cost increases and delays
  - Shipping container shortages
  - Increases in packaging costs
  - Increases in storage costs
  - Port congestion
  - Lack of labor for loading/unloading
  - Lack of truck drivers



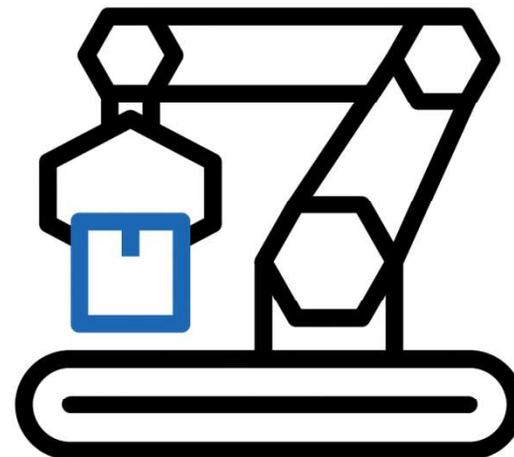
# Outlook: It is going to get worse before it gets better

- More disruptions inevitable
  - COVID-19 was the perfect “stress test”
  - Globalization of supply chains
  - Electrification of everything
  - Contrasted against JIT, lean manufacturing, sole sourcing
- And what about all of the price increases, stop-ship threats?



# Outlook

- Opportunity for manufacturers to reexamine their commercial contracts
  - Increased focus on supply chains and related planning
  - Never waste a good crisis
  - Look at shifting risk by reexamining contracts and making changes going forward

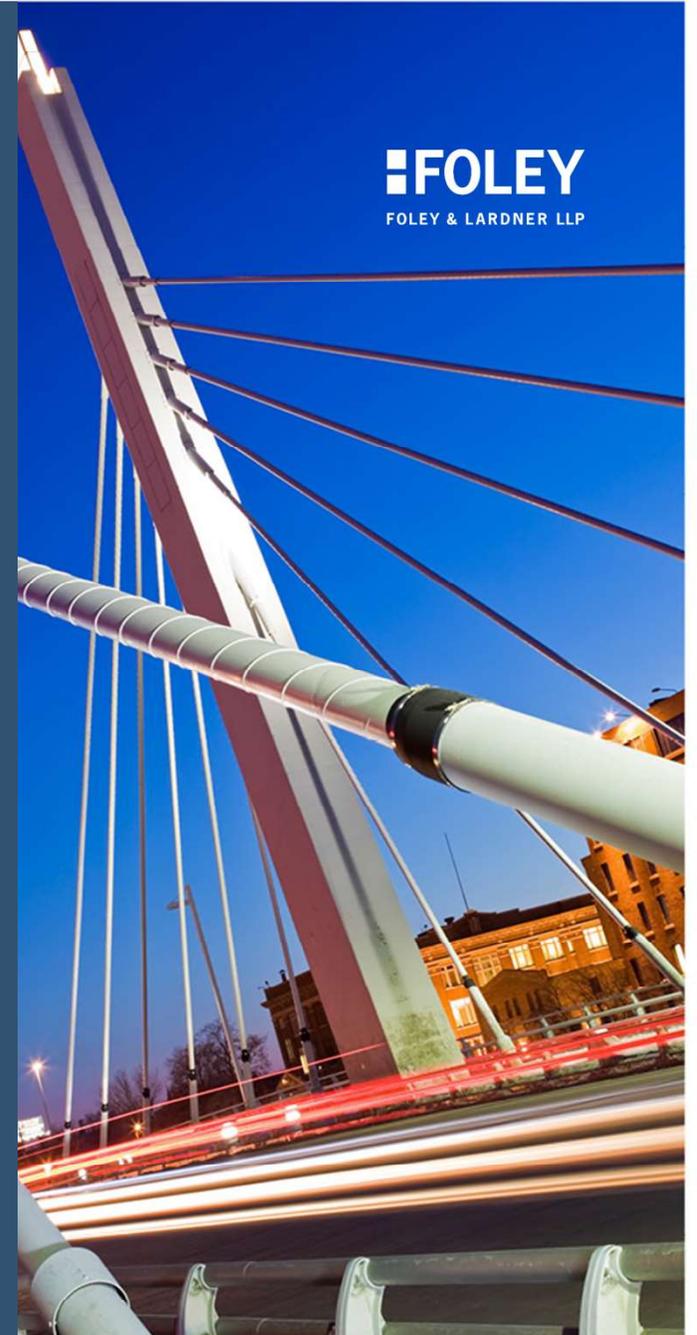


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# SUPPLY CHAIN DISRUPTIONS

## Overview of Key Legal Theories

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# Three Key Legal Theories

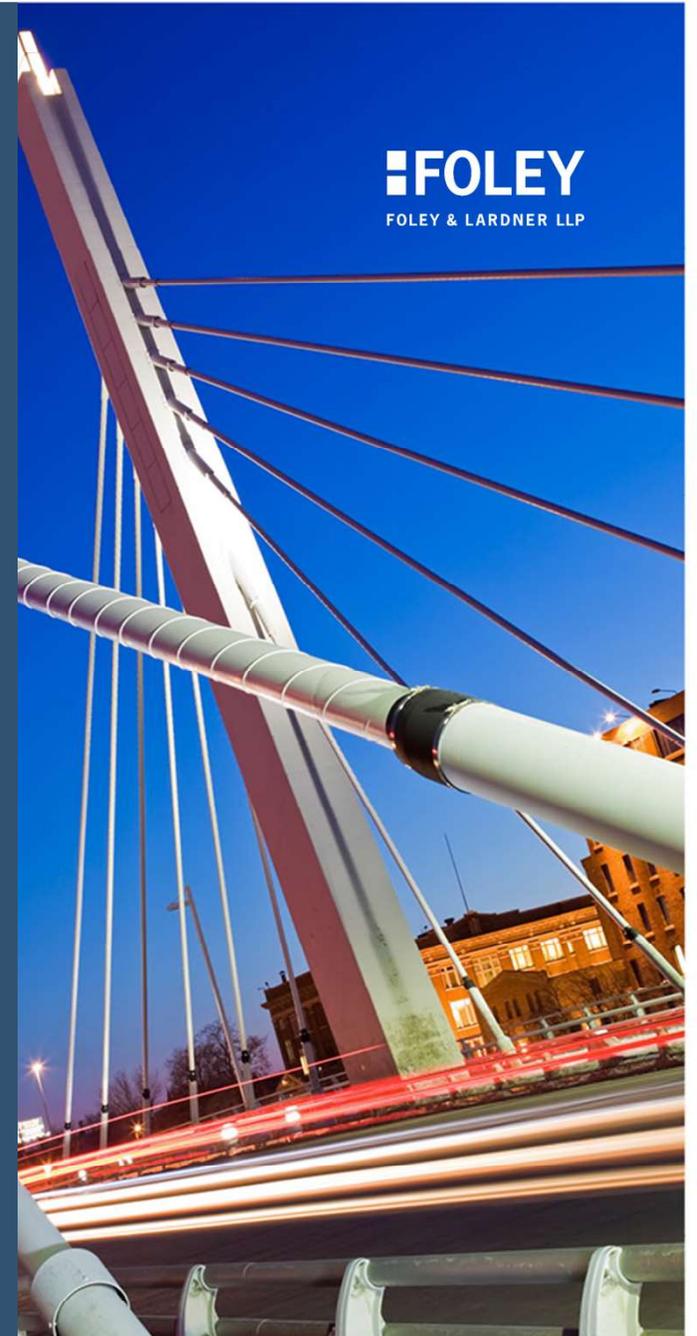
- These excuse performance under a contract; not in breach
  - *Force majeure*
    - First line of defense for unexpected supply issues—delivery prevented or delayed, raw materials unavailable, etc.
    - Performance is excused during the pendency of the force majeure event
  - Commercial impracticability
    - Backstop if force majeure provision is nonexistent or inapplicable
    - This is the proper “door” for the price increase requests (demands) that we are seeing
    - Show that performance has been rendered commercially impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made (UCC 2-615)
  - Frustration of purpose
    - Excuses non-performance when the purpose for entering into the contract is impeded by an unforeseen event
    - Nonoccurrence of the event was a basis for the contract

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# SUPPLY CHAIN DISRUPTIONS

## Injunctions, Specific Performance & Equitable Relief

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# Equitable Relief

- Four elements necessary to obtain injunctive relief:
  1. Likelihood of success on the merits
  2. Irreparable harm
  3. Balance of the harms
  4. Public policy/interest
- Majority of commercial/supply chain disputes turn on the first and second elements
  - Although in case trends, you will see judges will give weight to elements three and four to obtain desired outcome

# Equitable Relief

- Likelihood of success on the merits:
  - Is there an enforceable contract for future supply?
  - Claims of force majeure/commercial impracticability
- Irreparable harm:
  - Harm that cannot be redressed on final judgment by money damages

# Equitable Relief

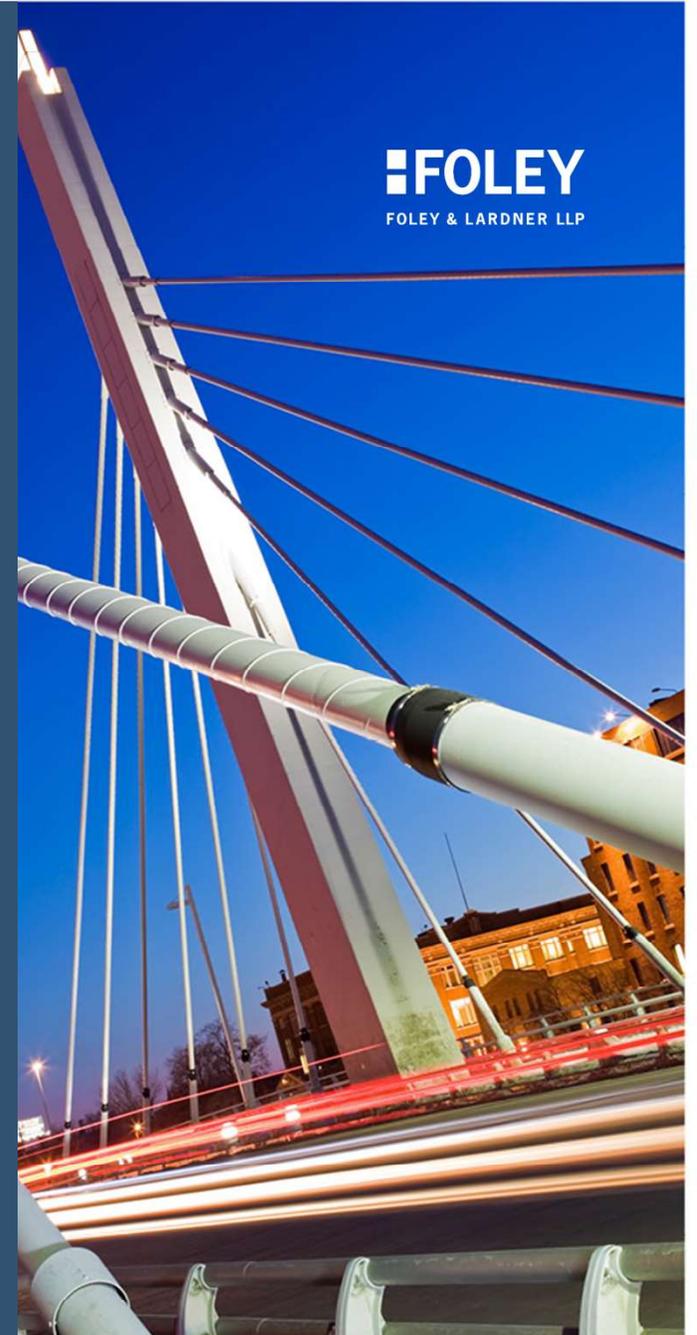
- Irreparable harm (cont.):
  - Creates a paradox when the dispute involves demands for a price increase
  - Duty to mitigate/ability to avoid the threatened harm
  - Payment under protest
    - Effect of supplier refusal to allow payment under protest

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# SUPPLY CHAIN DISRUPTIONS

## Case Law Trends

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# Case Law Trend #1

- Shortages may evoke force majeure provisions or the doctrine of commercial impracticability
  - Most courts view the pandemic as qualifying under FM provisions relating to “natural disaster” or “government action”
  - Using the pandemic as a “pretext” for excusing performance
    - As long as the FM provision is met, motivations are irrelevant
    - *JN Contemporary Art LLC v. Phillips Auctioneers LLC*, No. 20-4370, 2020 WL 7405262 (S.D.N.Y. Dec. 16, 2020)

# Case Law Trend #2

- Buyers have had limited success in obtaining injunctive relief in the face of supply shortages
  - Buyers attempting to force shipment or allocation in the face of a shortage have been found to be “unlikely to succeed on the merits”
    - *JVIS-USA, LLC v. NXP Semiconductors USA, Inc.*, No. 20-10801 (E.D. Mich. Apr. 16, 2021) (trial court order denying request for TRO)
    - *Inovia Pharmaceuticals, Inc. v. GeneOne Life Science Inc.*, No. 20-06554, 2020 WL 5047283 (Pa. Com. Pl. Aug. 25, 2020) (denying petition for preliminary injunction)

# Case Law Trend #3

- Whether the pandemic is considered “foreseeable” may depend on the court or your contract language
  - *GAP Inc. v. Ponte Gadea N.Y. LLC*, No. 20-4541-LTS-KHP, 2021 WL 861121 (S.D.N.Y. Mar. 8, 2021)
  - *UMNV 205–207 Newbury, LLC v. Caffe Nero Americas Inc.*, No. 2084-1493, 2021 WL 956069 (Mass. Sup. Ct. Feb. 8, 2021)

# Case Law Trend #4

- Sellers are pushing back on “payment under protest” language
  - *E.g., HBPO Northern America, Inc. v. U.S. Farathane, LLC*, Case No. 21-190331 (Mich. Cir. Ct., Oct. 6, 2021) (order granting request for preliminary injunction)

# Case Law Trend #5

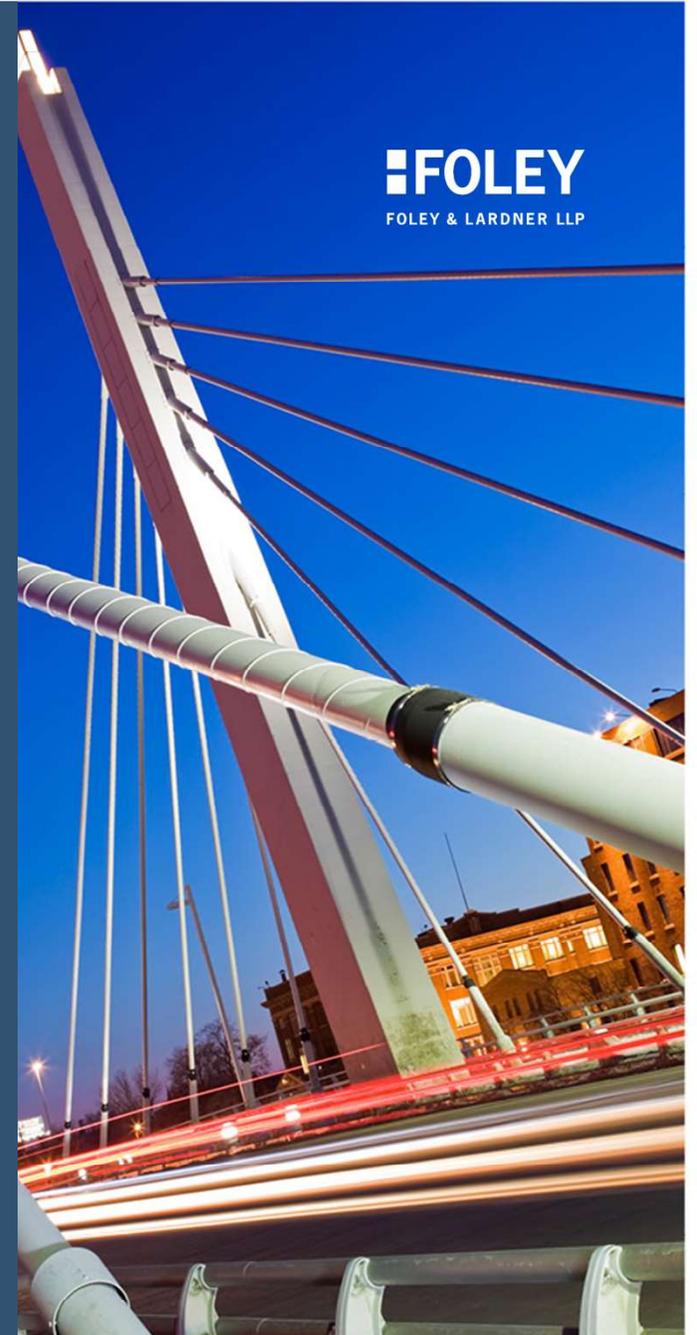
- Pendulum may be starting to swing back toward buyers in situations in which seller uses pandemic and supply chain issues in an effort to leverage price increases or commercial concessions, particularly if the seller is refusing to allow buyer the opportunity to pay under protest
  - *HBPO Northern America, Inc. v. U.S. Farathane, LLC*, Case No. 21-190331 (Mich. Cir. Ct., Oct. 6, 2021) (order granting request for preliminary injunction)
  - *Isuzu North America Corporation v. Progressive Metal Manufacturing Company*, Case No. 2:21-cv-12358 (E.D. Mich., Oct. 19, 2021) (order granting request for temporary restraining order)

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# SUPPLY CHAIN DISRUPTIONS

## Strategies for Managing Requests for Price Adjustment

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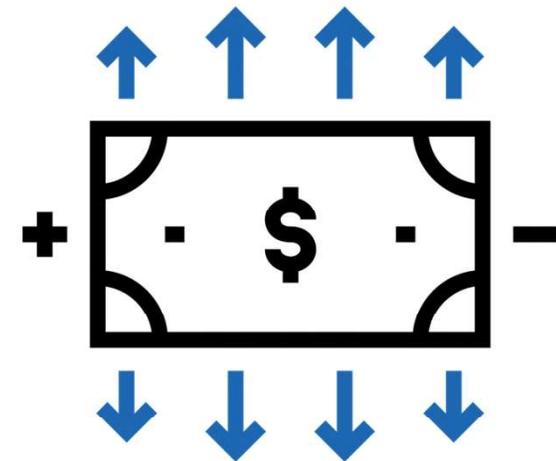


# Strategies for Managing Requests for Price Adjustment

- Most important consideration
  - Maintain continuity of supply
- Initial considerations
  - Is there an enforceable contract requiring supply?
    - Quantity
    - Duration
  - Does contract provide grounds for the request?
  - Claims of commercial impracticability/force majeure
  - What requests has buyer made from its own customer?

# Strategies for Managing Requests for Price Adjustment

- Potential responses/remedies
  - Request for adequate assurance
  - Payment under protest
    - Setoff against last invoice
    - Pursue recovery through a lawsuit
  - Involve the customer
  - No bid list
  - Legal action

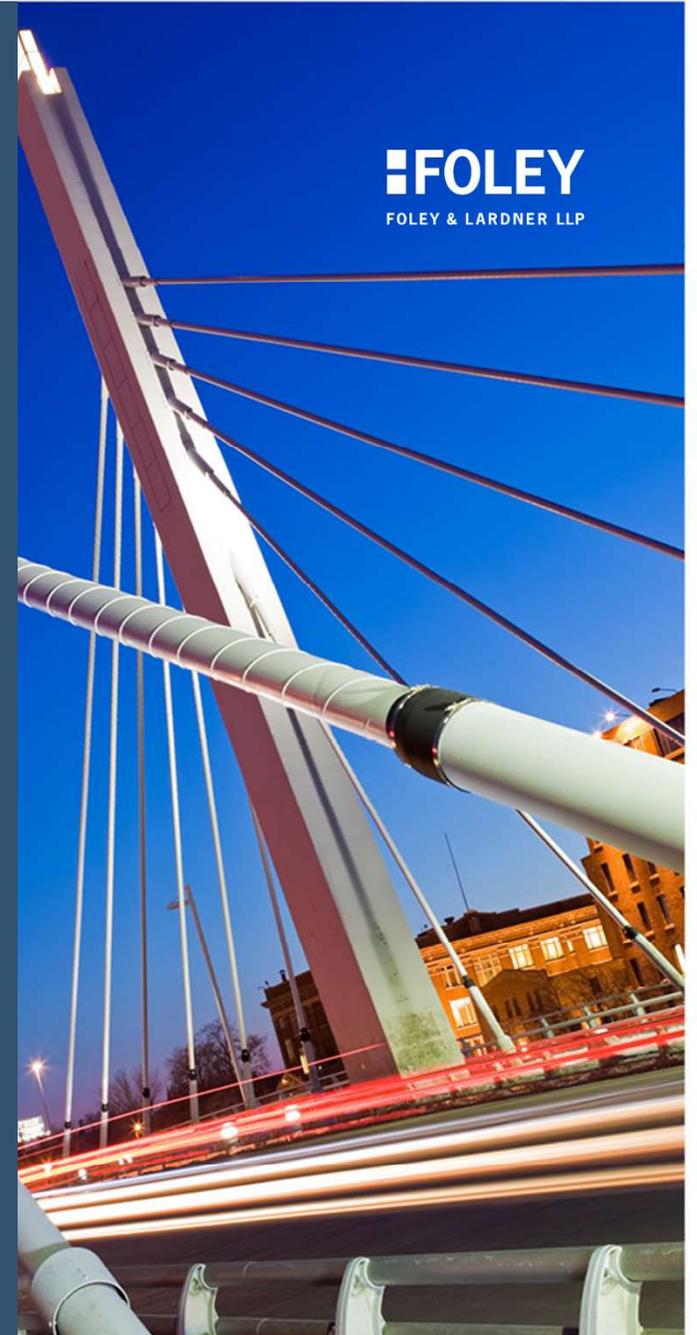


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# SUPPLY CHAIN DISRUPTIONS

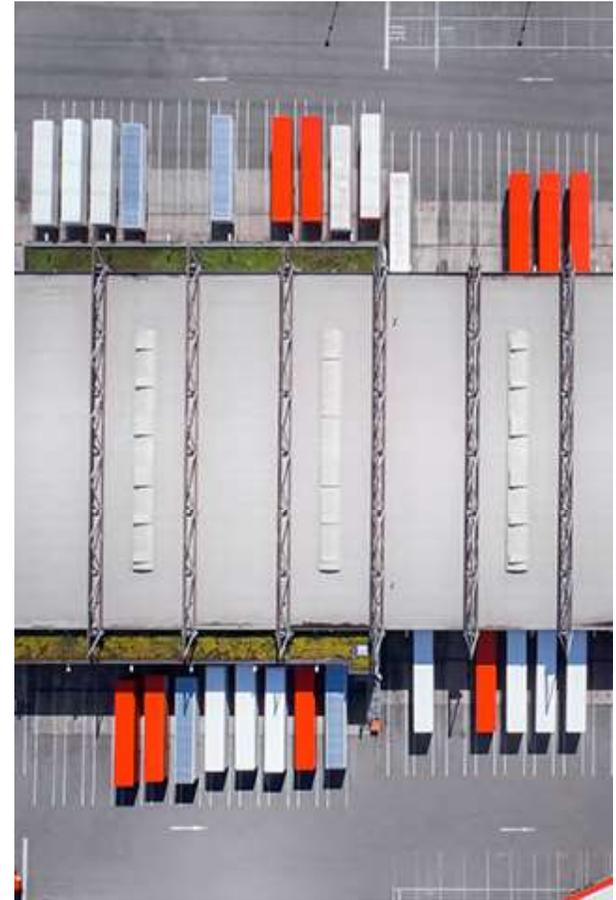
## Preparing For Litigation

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# Preparing for Litigation

- Failure to meet delivery or volume requirements
- Supply chain shortages and stoppages lead to increased warranty/recall claims
- Products and assemblies are more vulnerable due to changes needed to keep continuity of supply
  - The use of alternate suppliers
  - Expedited approvals
  - “Cold start” issues during ramp up
  - Shipment of stored products that may have degraded or been damaged
  - Issues with machine maintenance
  - Untrained employees and personnel due to additional hiring needs



# Preparing for Litigation

- Ensure your team is ready for a dispute
  - Train your employees in the event litigation becomes inevitable
  - Know what documents constitute your contract
  - Know whether your contract contains notice provisions, arbitration clauses, forum selection clauses and/or venue clauses
  - Understand the concept of “building a record” with respect to the ongoing supply chain dispute
  - Identify key members of the business team with information regarding a dispute, and prepare a chronology of events
  - Do not put anything in an email (or text or chat) that you would not want to be read aloud in court
  - Understand when the attorney-client privilege does and does not attach to communications and documents

# Preparing for Litigation

- Track all damages and costs related to the pandemic, line downs, delays, other freight issues and supply chain shortages
  - Warehousing costs, return costs, freight expedites, overtime and ramp-up costs
  - Opportunities to leverage these costs during commercial negotiations with important customers and suppliers when discussing new business
  - Pandemic doesn't necessarily trigger renegotiations, but some provisions may make sense to revisit



# Preparing for Litigation

- Consider how your contract may be affected by the “new normal” and which party should bear the risk going forward
  - Extended lead times from suppliers
  - Expedited freight issues
  - Uncertain forecasts
  - Price increases due to decreased volume
  - Revised force majeure clause

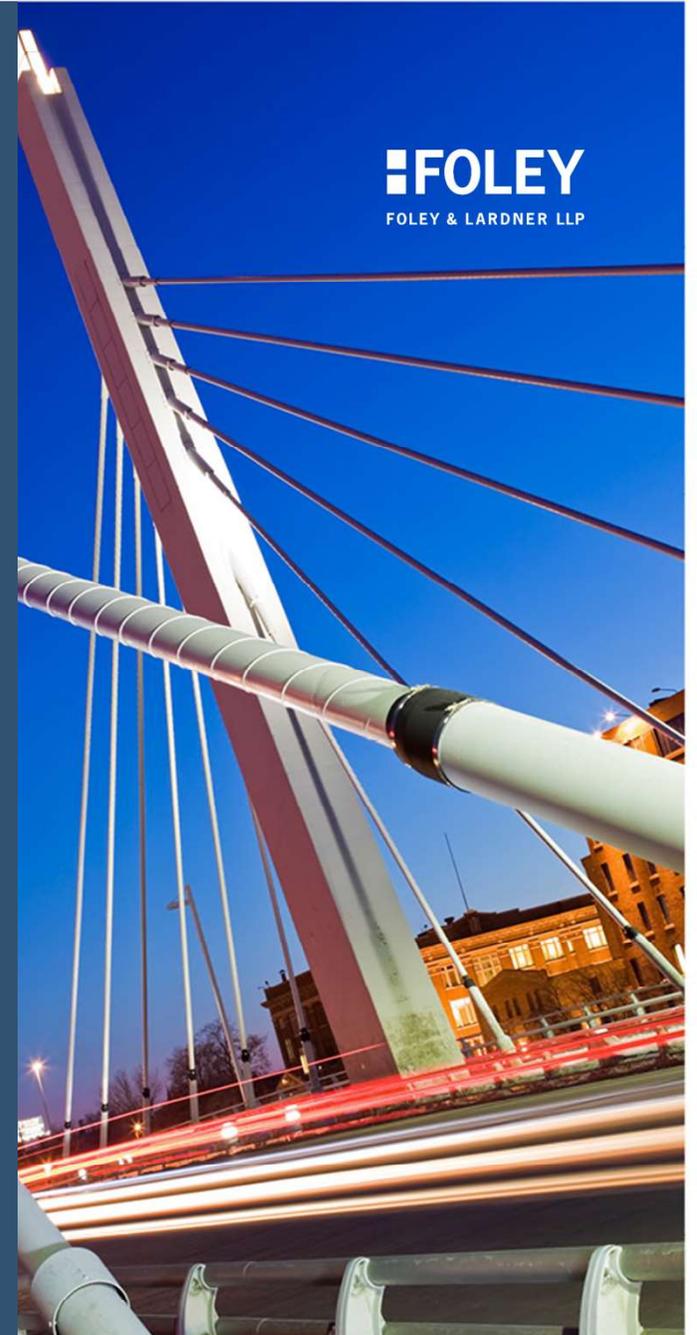


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# SUPPLY CHAIN DISRUPTIONS

## Lessons Learned

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# Lessons Learned

- Rules
- Suggestions
  - Not one-size fits all



# Suggestion #1

- Engage in a supply-chain mapping exercise and identify past issues



# “Those that fail to learn from history are doomed to repeat it.” – Winston Churchill

- Know your company’s supply chain and pain points
  - The who, what, where and how far away
  - Labor force
  - Freight & logistics
  - 3PL
  - Tracking technology and transparency
- Look beyond one tier below
  - Ex. What if both of your suppliers have the same raw material supplier?
- Important for both short- and long-term precautions



# Suggestion #2

- Revisit T&Cs and rewrite the *force majeure* provisions (plural!)



# Force Majeure



## KEY CONSIDERATIONS

### For Buyers

- List specific events, as narrowly as possible
- Exclude labor strikes
- Build-in prompt notice requirement and expected duration
- Shorten time to resume performance
- Need an “out” (escape hatch provision): right to terminate after certain time period



## KEY CONSIDERATIONS

### For Sellers

- Negotiate as broad of a list as possible
- Catch-all: “. . . or any other circumstance beyond the control of the parties” (very broad)
- Suspend performance until the force majeure event is over

# Suggestion #3

- Consider allocating certain risks and fluctuations through the contract (whether an amendment or at time of renegotiation)



# Fresh Look at Commercial Contracts

- Can and should consider how to allocate risk under the contract
- Consider risk assessment for existing LTAs and strategic suppliers
- Involve supplier/contract managers in all aspects
- Consider past issues, disputes, stop-ship threats, line downs, etc.
- Expect to see more indexing, thresholds, etc.



# Suggestion #4

- Consider fundamental changes to Just-In-Time (JIT), lean manufacturing model with sole-sourced supplier



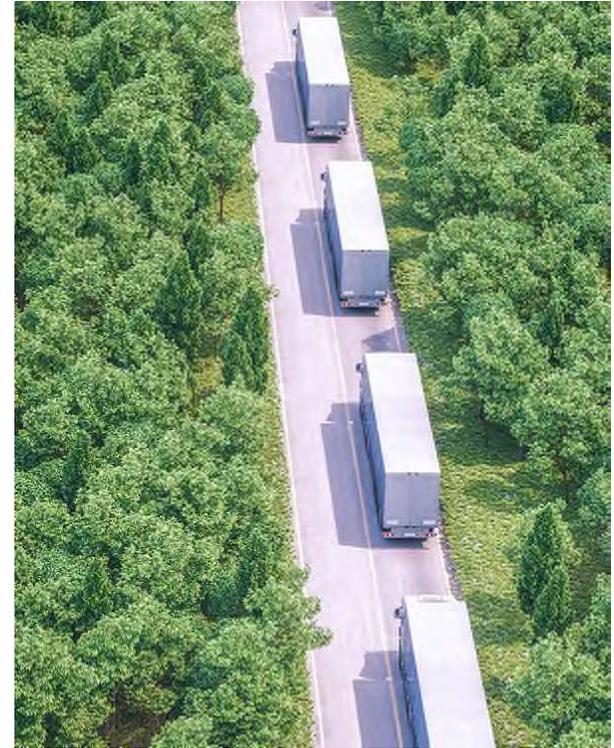
# Try to Avoid Some of the Problems with JIT

- Not possible across all components, raw materials and operations
- But are there some parts and raw materials that can be:
  - Dual-sourced (and from different locations)
  - Warehoused or stockpiled in some quantity
  - Request safety stock to be held by suppliers
  - At least have a prequalified alternate source ready



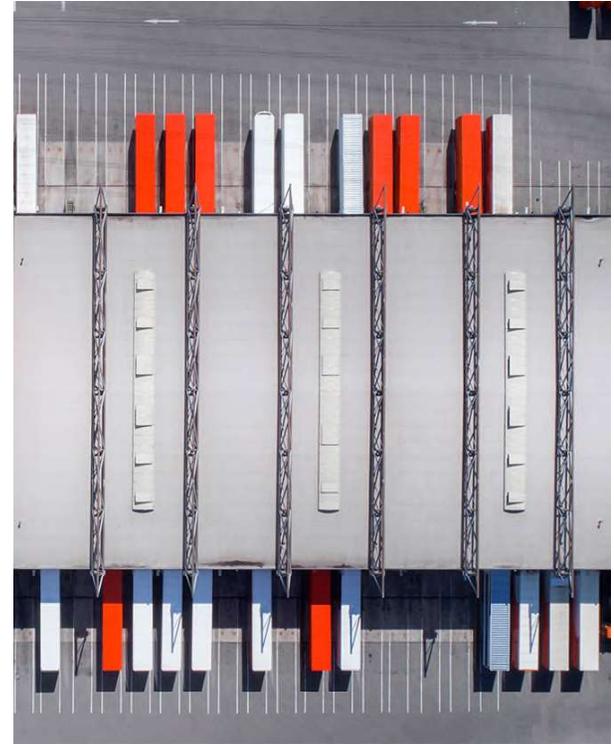
# Suggestion #5

- Consider fundamental changes to the length/distance of the supply chain



# Reshoring/Nearshoring/Regionalization

- Easier said than done
- Long-term strategy
- Many companies are taking steps to:
  - Source certain supplies and operations “closer”
  - In-house certain parts and functions
  - Acquire production facilities or enter into JVs
    - Ex. microchips and batteries



# Thank you



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# Environment, Social, and Governance and Supply Chain Risk Management

**Jonathan Chibafa**

15 March 2022



- 
- Introduction
  - Overview of Supply Chain
  - Latest Trends: ESG Risks
  - The United States: Uyghur Forced Labor Prevention Act
  - The United Kingdom: Modern Slavery Act 2015
  - The European Union
  - Case Study: Fast Fashion
  - Going Forward

- Corporate supply chains have become exceedingly complicated. Today, an estimate of 80% of global trade passes through supply chains.
- Outsourcing production to suppliers in countries with a cost advantage can deliver significant economic benefits.
- However, as supply chains fall outside of a company's core operations, they expose them to hidden and uncontrollable risks, typically driven by ESG factors, such as natural resource depletion, human rights abuses, and corruption.
- These risks can cause significant reputational, operational, and financial impact.

- Supply chain transparency with companies accountable for the whole supply chain, no longer turning a blind eye to sub-standard practices.
- Paying a fair or living wage in all countries of operation and implementing a supply chain model that enables social benefit in poorer communities in which we operate.
- Enforcement in human rights issues across supply chains are becoming a director accountability.
- Responsibility for assessing and policing your supply chains with these issues dealt with in the boardroom and in the public view.
- *Establish supply chain risk management / vendor assessment process and report on supply chain risks to the board*

# Latest Trends: ESG Risks

- Environmental pollution
- Shortages of raw material and natural resources
- Workforce health and safety incidents
- Human rights considerations
- Labour disputes
- Corruption and bribery
- Geopolitical considerations



# The United States: Uyghur Forced Labor Prevention Act

- On 23 December 2021, President Biden, announced strong measures and signed the Uyghur Forced Labor Prevention Act into law (coming into effect in June 2022), banning all imports into the United States from Xinjiang, China's Uyghur Autonomous Region.
- The new law is intended to tighten the economic screws on China and refrain from engaging in widely reported crimes against humanity and possibly genocide against the Uyghur population and other mostly Muslim ethnic groups that populate those regions.
- Under the act, the onus will be on the importer to rebut the presumption that the goods were made with forced labor in order for those goods to come into the United States.
- This will lead to enhanced supply chain due diligence at all levels of the supply chain.

- In January 2021, the UK government imposed obligations on British businesses to publish an annual statement disclosing the steps they took to ensure that there is no slavery or human trafficking present within their organization or supply chain. The obligations apply to organizations who:
  1. carry on business or part of their business in the UK;
  2. supply goods or services; and
  3. are above a certain size (currently GBP 36 million annual global turnover).



- On September 15, 2021, the European Commission announced plans for a ban on products made by forced labor to be proposed in 2022.
- The proposal requires companies to report on any violations to international rules on child labor, workers' rights, or environmental damage.
- Firms that fail to act could face fines as well as compensation claims.
- This obligation will force companies to operate their business activities, including their global supply chains diligently.

# Case Study: Fast Fashion

- Fast fashion is a model of mass-producing cheaply made, “of-the-moment” items that are sold at a lower price.
- Fast fashion’s impact on the planet, people, and animals is enormous. The pressure to reduce costs and speed up production time means that environmental corners are more likely to be cut. For example, use of cheap, toxic textiles and dyes, and the creation of an alarming amount of textile waste.
- Garment workers have also been found to work in dangerous environments for low wages, and without basic human rights.
- Animals are also impacted by fast fashion, from their skin and fur being used to make products, to the toxic chemicals and microfibres that are released in waterways and that are often ingested by ocean life.



- More than ever, businesses worldwide need to work on supply chain transparency and ensure they are ready to deal with any restrictions/bans on imports and monitor exports.
- Companies must understand the ESG impacts of the company's products and services along the entire life-cycle is key to identify potential risks.
- Key performance indicators for suppliers help understanding and managing these risks.
- Codes of conduct in supplier contracts and incentive structures can improve awareness and eventually performance. Furthermore, collaboration with industry peers, civil society and regulatory authorities is also important to effectively manage existing and emerging ESG supply chain risks.

# Questions?

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# Global Coverage

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