

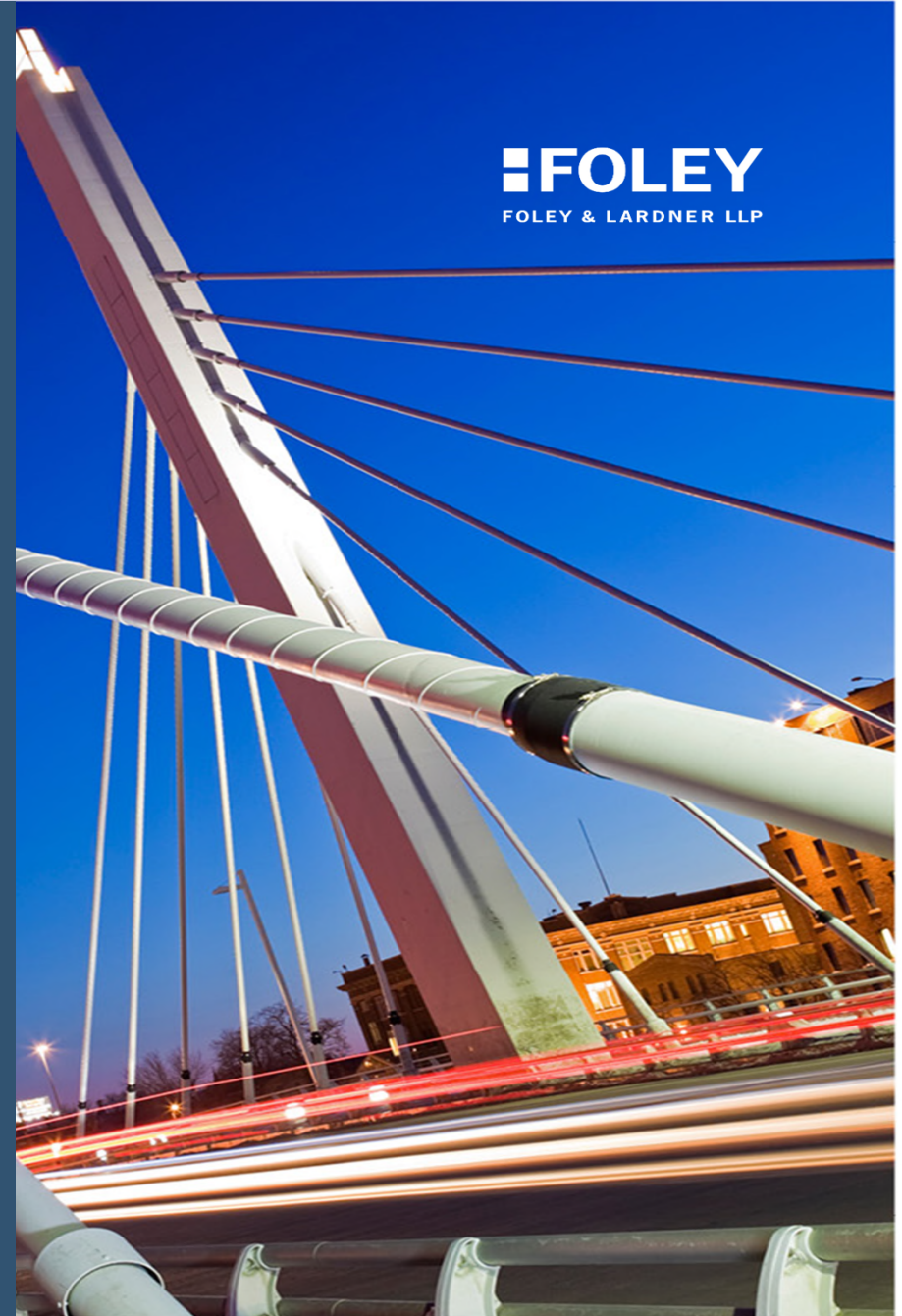
Wednesday, December 7

8:30 – 9:30 AM

SUPPLY CHAIN CHALLENGES IN 2023

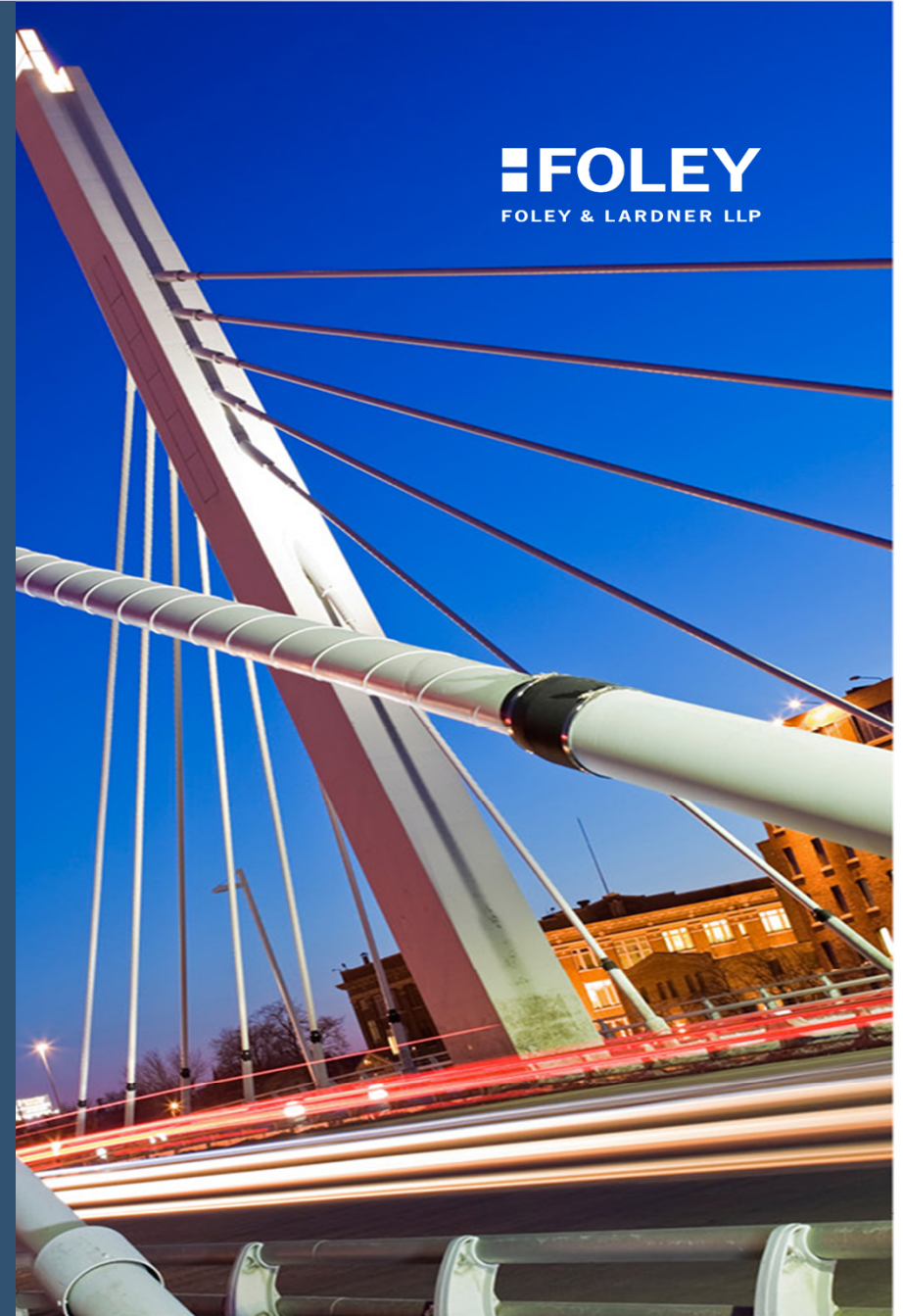
A Panel Discussion on Managing Compliance Risks, Rising Costs, and Delivery Delays

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Overview of Key Legal Theories & Injunctions

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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
 - Common example: object of the contract is destroyed

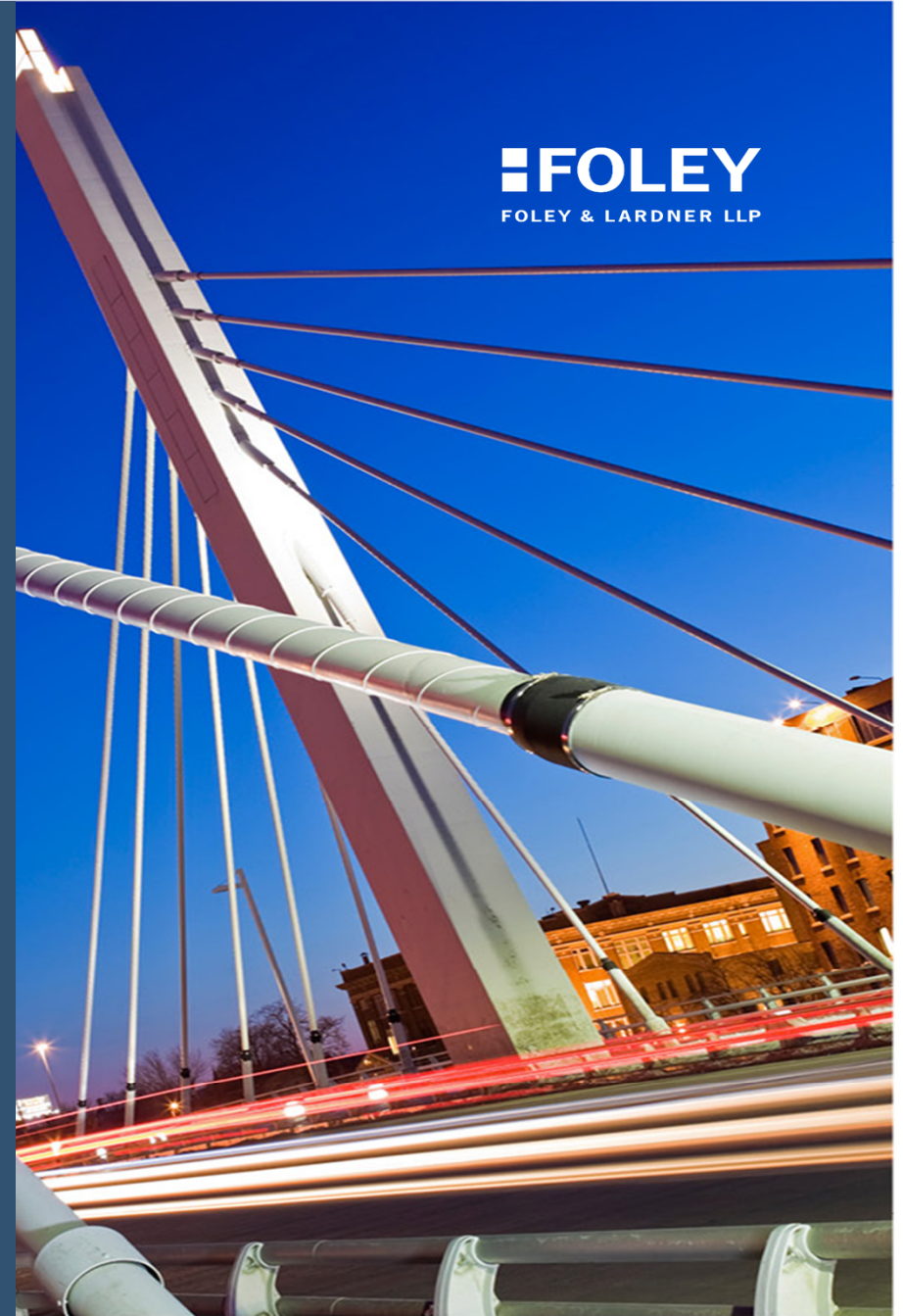
Equitable Relief

- 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

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

- When does *force majeure* end?
 - COVID domino or ripple effect
 - Case-by-case basis
 - Expect to see more new case law on *force majeure*
 - Contracts entered into after COVID
 - Foreseeability at the time the parties entered into the contract
 - Key defense to performance will always turn on whether a party is able to perform, even if performance is more expensive

Case Law Trend #3

- Buyers have had limited success in obtaining injunctive relief in the face of true 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 #4

- Pendulum may be starting to swing back in 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
- Three recent cases to illustrate nuances . . .

Woodbridge Corp. Inc. v. Peterson American Corp. Oakland County Circuit Court Case No. 2022-193979 (May 11, 2022)

- **Key Issue:** For purposes of determining whether to issue an injunction requiring seller to continue shipments, does a buyer face risk of irreparable harm when it has the option to pay a disputed price increase under protest?
- **Holding:** No. Buyer had an adequate legal remedy available whereby it could pay under protest and then seek to recover damages at trial.
- **Significance:** Buyers seeking an injunction must consider carefully what other options, including payment under protest, may be available that could preclude an injunction.

HBPO North America, Inc. v. U.S. Farathane, LLC, **Oakland County Circuit Court Case No. 21-190331-CB (October 6, 2021)**

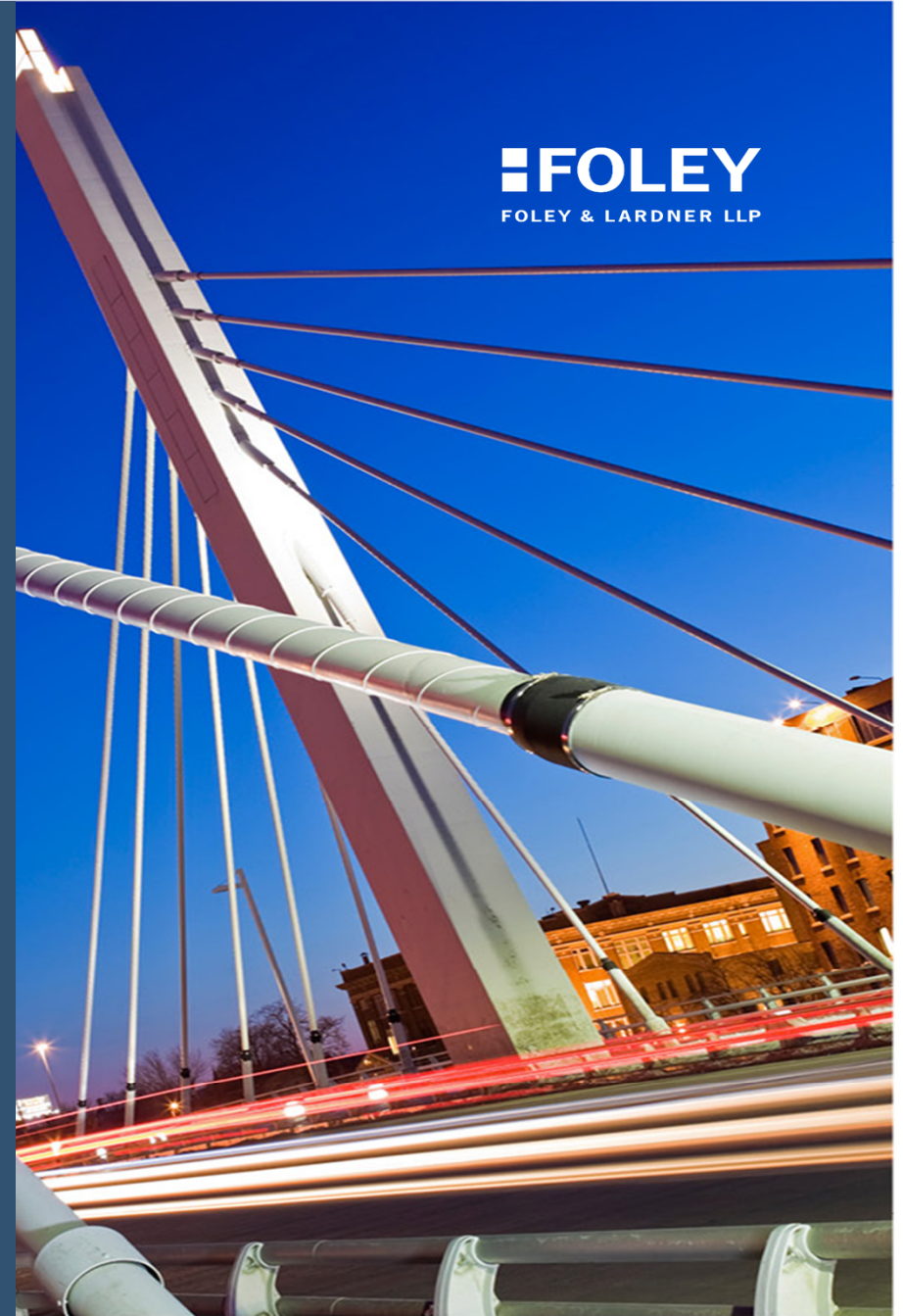
- **Key Issue:** For purposes of determining whether to issue an injunction requiring seller to continue shipments, does a buyer face risk of irreparable harm if a seller refuses to allow payment of a disputed price increase to be made under protest?
- **Holding:** Yes. If a seller requires the buyer to give up its legal claims as a condition to continuing shipments, buyer does not have a remedy to seek money damages and faces irreparable harm.
- **Significance:** A seller that refuses to allow shipment under protest creates a situation in which buyer faces irreparable harm and may be subject to an injunction. By implication, a buyer that retracts a previous reservation of rights may be deemed to have waived those rights.

BAE Industries, Inc. v. Agrati Medina, LLC, 2022 WL 4355139 (E.D. Mich., Sep. 20, 2022)

- **Key Issue:** Did increases in the cost of steel due to lockdowns and war in Ukraine excuse performance due to commercial impracticability under Section 2-615 of the UCC?
- **Holding:** At least for purposes of showing likelihood of success on the merits at preliminary injunction stage – No. Increased cost of performance was not sufficient grounds to show commercial impracticability.
 - Court noted in particular that the force majeure clause in the applicable contract specifically excluded claims of force majeure due to changes in cost, which assigned risk of such cost increases to the seller.
- **Significance:** Sellers seeking price increases must be mindful of the limits of the doctrines of commercial impracticability and force majeure.

INDUSTRY TRENDS AND LESSONS LEARNED IN THE SUPPLY CHAIN

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Lessons Learned

- Rules
- Suggestions
 - Not one-size fits all



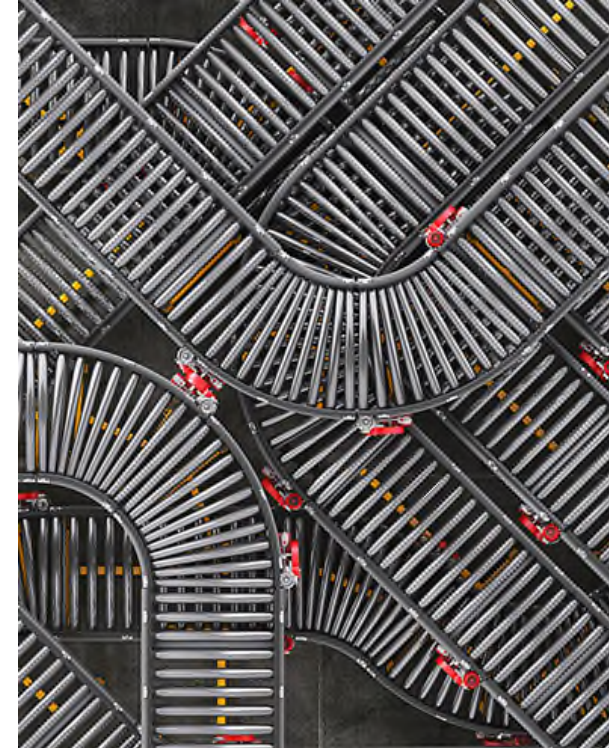
Suggestion #1

- Engage in a supply-chain mapping exercise and identify past issues (do not begin with COVID-19)



“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)
 - Indexing or price shifting provisions for raw material increases
 - Volume targets
 - Provisions addressing expedited freight costs



Fresh Look at Commercial Contracts

- Can and should consider how to allocate risk under the contract
- Consider risk assessment for existing Long Term Agreements (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, hedging, thresholds, etc.



Suggestion #4

- Be on the Lookout for Troubled Supplier and Troubled Customer Red Flags



Managing Financially Troubled Suppliers, Vendors and Customers

- Warning signs
 - Missed, late, frequent expedites, or short shipments (or payments)
 - Low quality shipments
 - Unprofitable operations (delay of new program launches)
 - Failure to pay sub-tiers/stretched payables
 - Requests to change payment terms
 - Sudden or frequent changes in management or key personnel

Managing Financially Troubled Suppliers, Vendors and Customers

- Assemble cross-functional team, including purchasing/sales, operations, treasury and legal
- Consider exit strategy
 - Suppliers – availability of alternative sources of supply
 - Customer – Desirability of continued relationship
- Meet with the supplier/customer and supplier's lender(s)
- Involve end customers
- Determine course of action
 - Is supplier viable?
 - Cost benefit analysis of resourcing vs. staying the course

Managing Financially Troubled Suppliers, Vendors and Customers

- If forced to stay:
 - Document any accommodations and the expectation in return for those accommodations
 - Supplier's commitment to continue production
 - Lender's commitment to continue lending
 - Establish milestones to gauge performance
 - Acknowledge ownership of any tooling or company property in supplier's possession

Suggestion #5

- Consider fundamental changes to JIT, lean manufacturing model with sole-sourced supplier



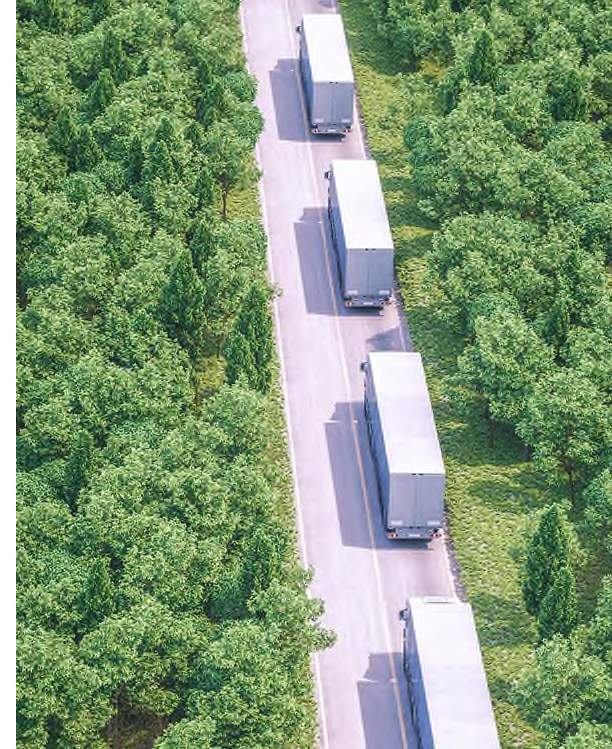
Try to Avoid Some of the Problems with JIT

- Not possible across all components, raw materials and operations
- But there are 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 #6

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



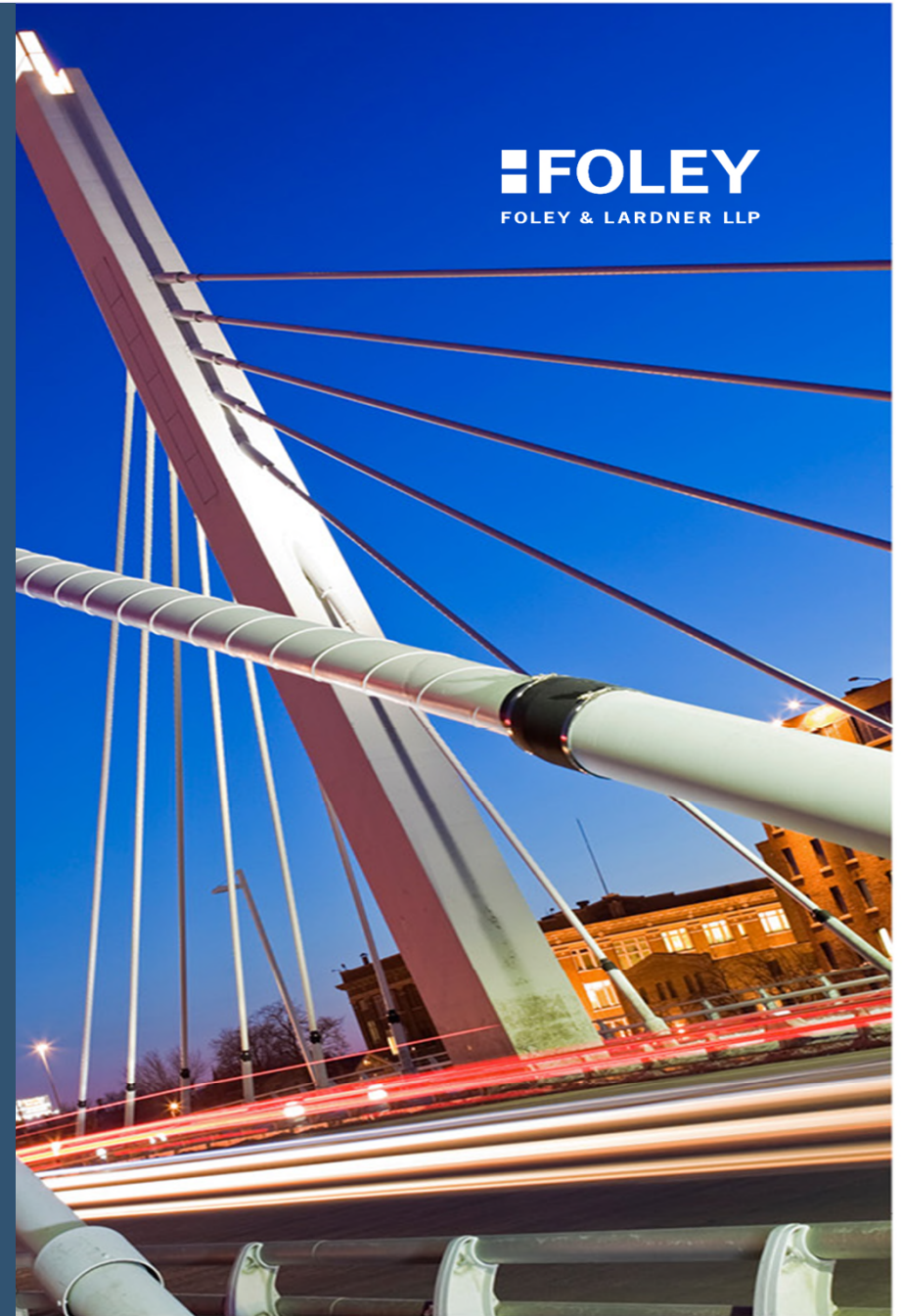
Reshoring/Nearshoring/Regionalization

- Easier said than done
- Long-term strategy (though finally beginning in Mexico)
- 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



COMPLIANCE ISSUES

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Compliance – Know Your Suppliers

- U.S. Customs & Border Protection
- Uyghur Forced Labor Protection Act
- Supply Chain Compliance

CBP - Introduction

- CBP facts

- Dept. of Homeland Security's largest and most complex component; more than 60,000 employees
- U.S. Treasury's second-highest source of income

- CBP's primary responsibilities

- Regulating goods entering U.S.
- Enforcing hundreds of U.S. regulations
- Securing/facilitating trade
- Keeping terrorists and their weapons out of the U.S.
- Collecting duties



Customs Role in Supply Chain Management

- Customs acts as gatekeeper for all imports
- Customs enforces both its own regulations and the import-related mandates of other agencies:
 - Department of Agriculture
 - Environmental Protection Agency
 - Food & Drug Administration
 - Department of Commerce and Department of State export controls
 - Department of Transportation / National Highway Transportation
- Violations can lead to dual penalties
- As U.S. Government has ramped up supply chain responsibilities, enforcement front line is when goods enter United States

Importer of Record (IOR)

- Customs Modernization Act of 1993 (the “Mod Act”)
 - Shifts most responsibilities for Customs compliance to the Importer of Record (IOR)
 - IOR responsible for using reasonable care when entering goods into the U.S.
- IOR responsibilities
 - Ensure that imported goods comply with local laws and regulations
 - File a completed duty entry and associated documents
 - Pay the assessed import duties and other taxes on goods
- Who is the IOR?
 - Usually the company importing the goods
 - Usually not the Customs broker or freight forwarder
 - Standard broker contract – liability generally limited to cost incurred for entry

Factors Driving Increase in CBP Activity

- Migration to the Automated Commercial Environment (ACE)
 - ACE portal allows for streamlined import process; central hub for Customs-related documents
 - But also provides ability for CBP to data-mine and identify anomalies
 - International trade war
 - Numerous antidumping and countervailing duty orders
 - Section 301 duties sharply increase duties from largest source of imports
 - Overly aggressive tariff engineering
 - Heightened focus on transshipment
 - Emergence of ESG and supply-chain challenges
 - E-allegations and Enforce and Protect Act (EAPA) allegations
 - Incentives for companies to report violations by competitors
 - Or non-profits with respect to ESG
-

UFLPA - Introduction

- Adds onto existing forced labor and human trafficking requirements
- Uyghar Protection Act (UFLPA) signed into law December 23, 2021 and effective June 21, 2022
- Bans the import of goods produced in the Xinjiang Uyghur Autonomous Region (XUAR)
- CBP places entities found to be using forced labor on the UFLPA Entity List (<https://www.dhs.gov/uflpa-entity-list>), blocking their entry

Presumption of Forced Labor

- Includes any goods that are mined, manufactured, or produced in Xinjiang, wholly or in part;
- Goods produced by entities that work with the Xinjiang regional government to recruit, transport, transfer, harbor, or receive forced labor out of Xinjiang;
- Export products to the United States that are:
 - Made wholly or in part in Xinjiang; or
 - Made by entities that work with the Xinjiang regional government to recruit, transport, transfer, harbor, or receive forced labor out of Xinjiang;

Presumption of Forced Labor (continued)

- Source material from Xinjiang;
- Source material from persons working with the Xinjiang regional government or the Xinjiang Production and Construction Corps. (XPCC) in connection with government programs that use forced labor, such as the “poverty alleviation” and “pairing-assistance” programs; or
- Products made by companies based outside of XUAR and outside of China that source material from XUAR or produce even a portion of the product inside XUAR.

Rebuttable Presumption

- To rebut the presumption, importers must meet the high bar of showing that:
 - The goods were not produced wholly or in part by convict labor, forced labor, or indentured labor;
 - The importer has complied with diligence requirements; and
 - The importer has been responsive to CBP follow-up inquiries

Challenges to Detention

- Standard is “clear and convincing evidence”
- Importer has 30 days to challenge detention
- After a shipment is detained, importers must:
 - Respond to all CBP requests for information about merchandise under CBP review;
 - Demonstrate by clear and convincing evidence that the good, ware, article, or merchandise was not mined, produced, or manufactured wholly or in part by forced labor; and
 - Demonstrate due diligence processes, effective supply chain tracing, and supply chain management measures to ensure that they do not import any goods made, in whole or in part, by forced labor.

Challenges to Detention (continued)

- If outside the scope of the UFLPA, provide information that the imported goods are:
 - Sourced completely from outside the XUAR and
 - Have no connection to entities on the UFLPA Entity List
- If CBP determines that the information provided by the importer demonstrates that the merchandise is outside the scope of the UFLPA, the importer will not need to overcome the UFLPA rebuttable presumption
- If an importer demonstrates by clear and convincing evidence that the goods were not made wholly or in part with forced labor, CBP will grant an exception to the UFLPA presumption and allow importation

Questions?



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