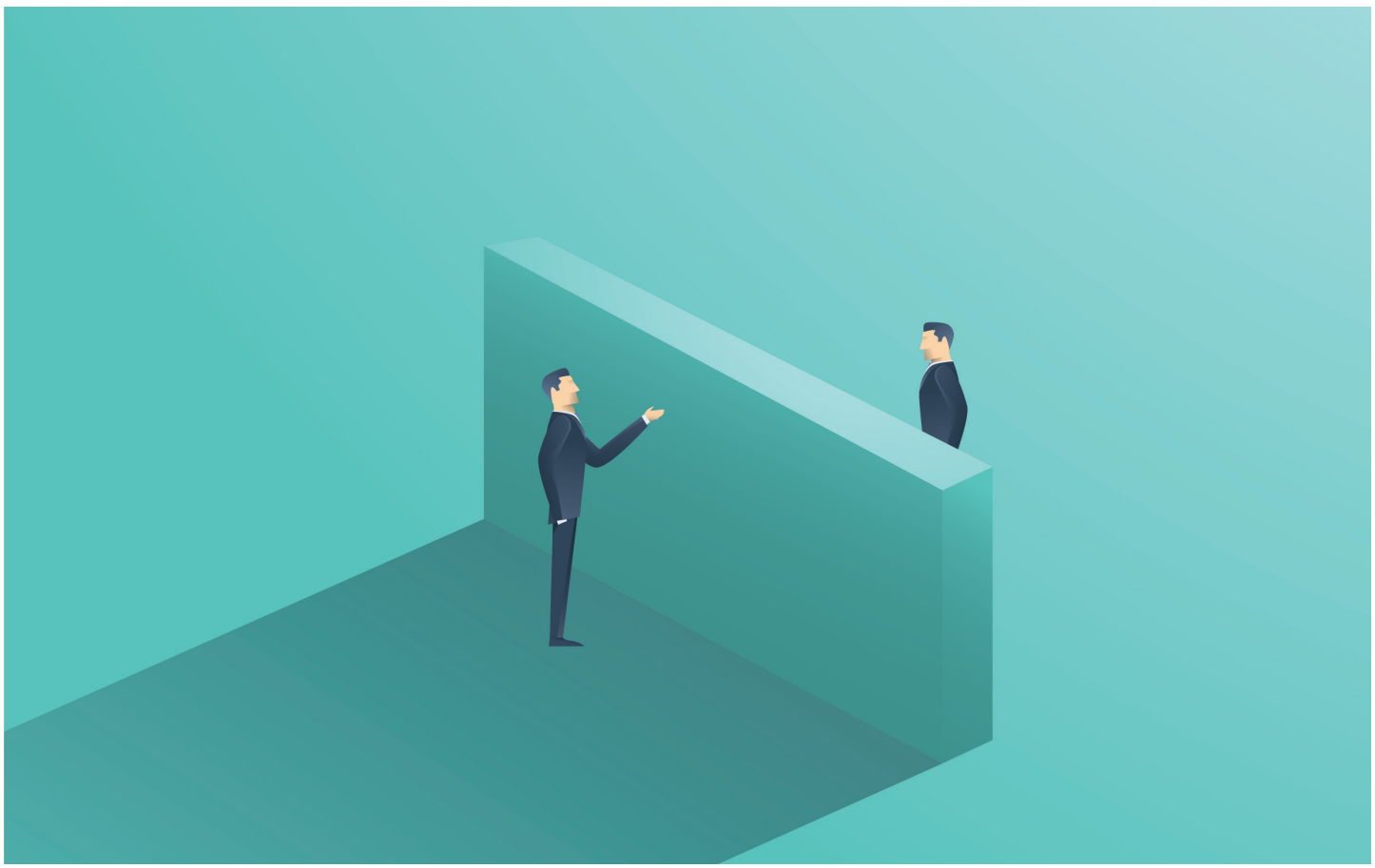
SPECIAL REPORT REPRINT June 2023

International disputes: supply chain disruption

FW discusses international disputes and supply chain disruption with Craig Montgomery at Freshfields Bruckhaus Deringer LLP, Katherine Hope Gurun at JAMS and James Mayers at Quinn Emanuel Urquhart & Sullivan, LLP.



Q&A:

International disputes: supply chain disruption

FW discusses international disputes and supply chain disruption with Craig Montgomery at Freshfields Bruckhaus Deringer LLP, Katherine Hope Gurun at JAMS and James Mayers at Quinn Emanuel Urquhart & Sullivan, LLP.

THE PANELLISTS

Craig Montgomery
Partner
Freshfields Bruckhaus Deringer LLP
T: +44 (0)20 7716 4888
E: craig.montgomery@freshfields.com

Craig Montgomery is a partner in Freshfields Bruckhaus Deringer LLP's dispute resolution practice and restructuring and insolvency practice. He has a broad practice, advising on a range of matters, including contentious restructuring and insolvency matters, especially complex matters in regulated industries or involving cross-border issues. He also specialises in aviation disputes and restructurings. He is a fellow of INSOL International.

Katherine Hope Gurun
Mediator, Arbitrator and Neutral Evaluator
JAMS
T: +1 (212) 751 2700
E: kgurun@jamsadr.com

Katherine Hope Gurun joined JAMS in September of 2006 as a mediator and arbitrator. Ms Gurun was formerly senior vice president and general counsel of Bechtel Corporation, one of the world's premier engineering and construction companies. Her experience spans both private industry and public service in engineering and construction, business, energy, project finance, joint ventures, risk management and nuclear disarmament.

James Mayers
Of Counsel
Quinn Emanuel Urquhart & Sullivan, LLP
T: +974 6620 6649
E: jamesmayers@quinnemanuel.com

James Mayers is of counsel in Quinn Emanuel's Doha office. His practice focuses on all aspects of high value contentious and transactional construction law in the UK, Middle East and Asia, specialising in multibillion-dollar oil & gas, energy and infrastructure projects. He has represented clients across various industry sectors and in numerous dispute resolution forums, including mediation, adjudication, expert determination, international arbitration and litigation.

FW: Could you provide an overview of the key risks currently permeating international supply chains? To what extent are these risks fostering potential disputes?

Montgomery: Current disruption and risk to supply chains includes economic factors, such as supplier insolvency, due to the difficult economic environment, skills shortages intensified by the coronavirus (COVID-19) pandemic, input shortages due to international conflicts, notably the war in Ukraine, geopolitical change including US and China trade disputes, as well as price escalation and volatility, especially in construction and energy. More broadly, economic sanctions, trade tariffs and changes of law have been a factor, including increasingly tight environmental, social and governance (ESG) requirements, whether from counterparties, external regulation or soft law. This is leading to disputes where parties may be unable to perform their obligations, at least without delay or significant additional cost. Supplier violations of ESG rules or sanctions could also lead to disputes around such violations being attributed to purchasers and with investors and regulators.

Mayers: What makes the current situation particularly stark is that supply chain arrangements across various industry sectors are facing stress from numerous angles, within several tiers and at the same time. Current geopolitical uncertainty, economic and currency volatility in key markets, coupled with general inflationary pressures, availability of raw materials, labour shortages, international logistics disruption and increasing occurrences of cyber-related issues, are all individual catalysts for dispute, but when combined will exponentially increase risk. That inevitably causes tension with existing contractual arrangements, risk profiles and pricing models. The increasingly globalised nature and complexity of supply chains also increases the potential points of failure, leaving parties exposed to risk from which they might otherwise have been previously insulated.

Gurun: There are risks, of course, that are industry specific, but today all companies face challenges as to where to base their operations – onshore, offshore and nearshore – the unpredictability of the supply of raw materials, component parts and their high cost, labour and transportation, inflation, geopolitical tensions and the lasting impact of COVID-19 on the world. We need to remember that we have spent decades perfecting just-in-time delivery of component parts and services to produce a product or execute a project. Globalisation has prioritised the lowest cost and the highest speed over the resiliency, redundancy and durability of supply chain relationships, to say nothing of the effects on the environment and human resources. In the last three years, the world has been bombarded by COVID-19, the war in Ukraine, inflation and geopolitical instability, based in part on the desire to control critical natural resources and to use this control as a bargaining chip. The compact for world peace forged after World War II is under stress.

FW: Drilling down, how would you characterise the difficulties involved in identifying, assessing and managing potential risks across a supply chain that could lead to disputes?

Mayers: Supply chains are becoming increasingly complex and so issues affecting one tier can have wide-reaching implications. Enhanced due diligence of supply chain partners and their supply chains to identify points of potential failure would be ideal, helping to inform contracting and management strategy. However, obtaining this level of transparency is often difficult, if not impossible, to achieve. The extent to which it can be demanded will also depend on a party's particular bargaining position. Mapping supply chains, the associated known and unknown risks involved and identifying what can and cannot be controlled, will aid with the formulation of a management strategy, as will the implementation of contractual early warning mechanisms and audit rights. Traditional pass down obligations in head contracts are a necessary approach, but parties tend not to check compliance. While risk transfer remains an important contractual tool that still needs to be employed to protect positions, supply issues

are becoming so increasingly common that parties within relevant tiers also need to consider focused provisions for resolving execution issues when failures do arise.

Gurun: Companies need to understand the depth and breadth of their supply chain relationships. It is the weakest link that often is not spotted. It is possible a lower-tier supplier, which may be completely unknown to the principal, fails to perform, thus halting all production. Remember, the 1986 Challenger spaceship disaster was caused by a faulty gasket. Once supply chain participants are known, test them for their ability, technical and financial depth, and agility when adapting to intervening events. Increasingly, across the world, we stress-test our financial institutions, but how much due diligence do we actually do with a supplier? The future requires us to seek more stability and durability in supply chain relationships, and that can mean more support and investment from the companies that rely on these relationships.

Montgomery: In order to understand potential risks, companies need an understanding of their whole supply chain and particular pinch points. This may be difficult where suppliers do not have sufficient visibility of their own supply chain or governance processes. Companies need an ongoing process to develop and update their understanding of their existing supply chains – focusing on the most significant issues – human rights, criminal compliance, significant economic risks and major political turmoil. This should be coupled with detailed scrutiny when onboarding new suppliers, including database screening, searching open source material and public records, and a reputational review. Many damaging supply chain disruptions in recent years have been triggered by events that were not widely predicted, such as the pandemic and the invasion of Ukraine. Companies need processes and structures in place to respond swiftly to such developments and, where possible, diversification of critical supply chains to mitigate risk.

FW: In the event of a supply chain dispute, what options should companies consider toward resolution?

Montgomery: If a dispute can be resolved amicably, protecting continuity of supply, that is preferable, especially where the disrupting factor is out of either party's control. If that is not possible then formal renegotiation may be required, involving a full assessment of the contractual framework. If a critical supplier is experiencing financial difficulties, the company could consider providing funding or acquiring either the business or key assets to protect the supply. A common issue with supply chains is the failure of the supplier to deliver the goods or service. In such situations, careful thought should be given to which remedies will lead to the best commercial result. Under English law, the wronged party may have the option to terminate the contract or to treat it as repudiated, which will confer different rights and obligations, which should be carefully considered.

Gurun: Most supply chain disputes are resolved in the field or at a local level. Because quickly resolving disputes is so important to keep production or projects moving, companies should invest more in training teams to spot and solve issues. Also, companies should consider some newer alternative dispute mechanisms, such as having a professional neutral, project neutral or mediator on call to step in and assist with resolving disputes. This can be a person who has or develops a meaningful understanding of the industry-specific issues. This can be done virtually at a fraction of the cost of resolving the dispute later, when damages may be larger, positions more entrenched and facts more difficult to ascertain. For major and cross-supply chain issues, fast-track arbitration, which is offered by several arbitral organisations, should be considered. Also, European-style arbitration, which narrows discovery and may therefore reduce the time and cost of arbitration, is also a good option. Litigation in most jurisdictions is simply too lengthy and of course expensive.

Mayers: Difficulties can arise where parties fail to consider how their dispute resolution provisions are drafted and whether those provisions meet practical and commercial objectives in the context of wider contracting arrangements up and downstream. A multi-tiered dispute resolution strategy designed to initially avoid recourse to formal dispute resolution by way of negotiations or alternative methods of resolution, can assist and be effective in certain circumstances. However, where the parties' positions are entrenched, or significant sums are at stake, then such processes can simply serve to delay

> "SUPPLY CHAIN DISPUTES ARE LIKELY TO CONTINUE TO BE HIGH ON THE RISK AGENDA FOR COMPANIES AS LEVELS OF GLOBAL ECONOMIC AND POLITICAL SHOCK AND UNCERTAINTY REMAIN HIGH."
>
> CRAIG MONTGOMERY
> Freshfields Bruckhaus Deringer LLP

ultimate resolution. Enforceability of a judgment or award against the contractual counterparty and the process by which it can be achieved is often an issue which is not considered but is of crucial importance. This may drive whether, for example, arbitration or litigation is best suited to the circumstances. Other methods, such as expert determination, may be suitable in certain scenarios where the issues to be determined are of a technical nature not requiring determination of say, complex issues of law. However, as a purely contractual process, detailed consideration will need to be given at the contracting stage as to how the process is to be structured and executed, and how any resulting decision can be enforced.

> TIME SPENT ON A WELL DRAFTED AND FAIRLY NEGOTIATED CONTRACT GENERALLY HAS A VERY SIGNIFICANT PAYOFF IN REDUCED DISPUTES.
>
> KATHERINE HOPE GURUN
> JAMS

FW: How important is it for companies to include effective dispute resolution provisions in their contracts with suppliers? What issues should they evaluate when drafting such clauses?

Gurun: Dispute resolution clauses are necessary but not sufficient. Companies should always have consistent procurement documents that clearly set out the terms of the relationship, allow for modifications in the face of changing circumstances, establish the governing law of the contract and include dispute resolution provisions. Critically, these documents not only should be consistent for all participants in the supply chain or endeavour, but also should make it mandatory for related disputes to be settled jointly in the same forum under the same governing law. It is an enterprise-threatening proposition to find your company settling the same issues in two or more jurisdictions, under differing governing laws. Dispute resolution clauses should be simple and require, as the first step, that the direct participants on both sides try to negotiate a solution. To do this effectively, it is best that individuals already know each other, but this is not always possible in our digital world. Secondly, if direct negotiation fails, parties should be required to mediate the matter. Mediation is increasingly common in many jurisdictions, and it is far more cost and time effective than arbitration or litigation. Mediation need not be a process led by the corporate headquarters. It can be done locally or virtually. Mediations are most successful when businesspeople play a major role, as they often hold the key to an effective settlement. And most importantly, in a mediation the parties maintain control of their own fate.

Mayers: Effective dispute resolution provisions are an essential component of any commercial contract. There are many factors to consider, but those relevant to each contract will turn on the particular circumstances. Parties will often adopt model dispute resolution clauses without giving much, if any, thought to amendments required to suit their particular circumstances or the legal requirements necessary to ensure that they are enforceable. Conversely, parties can be overly prescriptive, which can remove flexibility. Both approaches typically lead to satellite disputes about the dispute resolution clause itself, which delays resolution of the substantive issues between the parties. It is essential to consider how the dispute resolution provisions, and allied provisions such as the governing law, align with those up and down the contractual chain to mitigate interface risks in circumstances where supply chain issues will more likely than not manifest in disputes across multiple contracts. For example, parties need to bear in mind that the interpretation of the same drafting can differ between jurisdictions, as can the remedies which might be available to them and their counterparties. This has the potential to create further exposure. Where multiple contracts and parties are involved, then consideration will also need to be given to issues such as joinder where arbitration is the resolution forum under the applicable contracts.

Montgomery: Effective dispute resolution provisions allow companies to achieve quick and satisfactory resolution. Parties should carefully consider which law and which forum – arbitration and courts of various jurisdictions – will best serve the objective of resolving potential disputes with most predictability and least disruption. Alternative dispute resolution (ADR) can be provided for in the contract, such as initial mediation. It can be cost-efficient compared to litigation and can help with quick resolution with the relationship preserved, but if unsuccessful it may delay overall resolution, so those factors will need to be balanced. Confidentiality, the availability of interim relief such as injunctions and specific performance, and enforceability of any judgment or award will also be important issues. It is important for drafting to be clear, as unclear provisions may not be enforceable. Disputes provisions should also cover the whole of the commercial

relationship, as disputes may arise which are not technically under the contract.

FW: In your experience, do companies regularly benefit from reviewing their existing supplier contracts? If those agreements are no longer fit for purpose due to changing circumstances, how might they approach the process of amending or renegotiating them?

Mayers: Regular contract review to ensure fitness for purpose is undoubtedly good practice. Laws and their application are constantly evolving. For existing arrangements, the ability to amend or renegotiate arrangements will depend on several factors, including the nature of the changed circumstances, the terms of the contract, the legal framework of the governing law applicable to the contract, and the party's commercial bargaining position. In formulating a renegotiation strategy, one needs to ideally have a detailed understanding of the counterparty's position and the commercial pressures faced by them, or which will be faced by them, in light of the changing circumstances. There also needs to be a comprehensive understanding of how the governing law of the contract regulates the interpretation of the existing contractual provisions which deal with changing circumstances, and what remedies are available to the parties in that situation. Statutory frameworks exist in certain jurisdictions which mandate renegotiation of terms in various circumstances to preserve the nature of the commercial bargain originally struck, whereas other jurisdictions do not recognise that concept. In the latter scenario, a comprehensive understanding of legal doctrines which may otherwise apply and the consequences of the same if they do, will be important to informing any renegotiation strategy.

Montgomery: As global economic and political circumstances evolve, especially in times of radical change, companies need to understand the impact on their existing contracts and commercial relationships. The nature of a business may also evolve over time, meaning that certain supplier relationships become more or less critical to the company. The relevant legal framework may also change, for example through sanctions or due to Brexit. Depending on the changes sought to be achieved, the process of renegotiating contracts can start informally, allowing changes to be made within existing commercial relationships. Informal renegotiations can be driven by members of staff at an operational level liaising with their counterparts. Where this is not successful, companies should consider their legal position before going into formal negotiations with more senior individuals. Provisions in the contract on price escalation, force majeure, sanctions and ESG compliance and allocation of liability will be very relevant to the negotiation.

Gurun: Regularly reviewing and rethinking existing supplier contract documents is essential. Large, successful corporations are often hesitant to take a fresh look at their procurement contract documents. They treasure all the corporate lore and experience that are reflected in their 40-page, long-form procurement order. But the truth is, if the best and brightest interdisciplinary teams are locked in a windowless conference room and told a document is needed that reflects the true needs of parties and the industry, the result will be a much shorter, much clearer document that can be adapted to changing needs around the world. Managing risk is a constantly evolving process. Should not the contracts that ultimately manage risk be agile and adaptable too? Moreover, time spent on a well drafted and fairly negotiated contract generally has a very significant payoff in reduced disputes.

FW: What essential advice would you offer to companies on implementing effective processes to monitor for potential disruptions and disputes across their supply chain, and to lay the groundwork for swift resolution?

Gurun: It is important to have a plan. As the boxer Mike Tyson is quoted as saying: "Everyone has a plan – until they get hit." Very few supply chain issues improve with age. Decide how contracts will allocate risk, transfer risk to those best able to bear it and decide how the residual risks will be covered. Stay alert, spot the signs of trouble and then act on the best information. Some risk can be managed by early detection and providing support to the supplier or by realistically deciding at an early stage that the supplier must be changed. Increasingly, companies will seek to contract for backup or alternate supplies, or will opt to maintain inventory. Some companies or investors will seek to control the entire supply chain. This is an option many cannot afford. Most

> "SUPPLY CHAINS ARE BECOMING INCREASINGLY COMPLEX AND SO ISSUES AFFECTING ONE TIER CAN HAVE WIDE-REACHING IMPLICATIONS."
>
> JAMES MAYERS
> Quinn Emanuel Urquhart & Sullivan, LLP

supply chain disputes must be resolved in real time in the field. Think about and plan for the worst-case scenarios.

Montgomery: Effective monitoring of supply chains can mitigate the effects of disruption. Legal requirements for this level of governance are also increasing, for example through the proposed EU Corporate Sustainability Due Diligence Directive. Monitoring mechanisms should include the following. First, a nerve centre for supply chain management and compliance, with pre-established procedures to reduce pressure in case of disruption and avoid corner cutting. Second, common methodologies and standards for continuous due diligence. Third, a framework of risk priorities, tailored to the specific supply chain and industry, including which partners are the most important or highest risk. Fourth, an early warning mechanism. Fifth, comprehensive data collection functions, such as press monitoring. Sixth, mechanisms to avoid a tick-box approach to compliance and to encourage reporting of concerns – internally and externally – with appropriate incentives. Finally, internal audit and regular review to ensure continued effectiveness.

Mayers: Each case will turn on its particular facts but the ability to expediently resolve a dispute depends on several factors, including how the parties have agreed to resolve disputes as part of their contract, the available evidence, the remedies available, and the appetite of both the parties and the court or tribunal to swiftly resolve matters. The dispute resolution forum initially chosen may not facilitate a swift resolution, which is why advance consideration of the drafting of the dispute resolution provisions in the context of likely disputes is so important. Active and effective contract management plays a key role in developing a dispute resolution strategy and that can only be achieved with a detailed understanding of the parties' respective contractual rights and obligations. A robust document management system needs to be in place so that evidence can be easily collated and navigated. Legal counsel should also be engaged quickly to assist with objectively assessing the facts and the evidence in order to identify where weaknesses may lie in a case and how they can be addressed.

FW: Looking ahead, do you expect to see a rise in supply chain disputes over the coming months and years? What trends are likely to dominate this space?

Montgomery: Supply chain disputes are likely to continue to be high on the risk agenda for companies as levels of global economic and political shock and uncertainty remain high and effective disruption insurance may be more difficult to obtain. However, companies with complex supply chains may have learned the lessons of recent years and implemented more robust arrangements and more sophisticated contracts, which will help to mitigate those risks. A trend that continues to emerge is the importance of ESG. There is a growing amount of legislation and stakeholder and public focus, which requires and enables greater transparency on supply chains and risk governance frameworks. This is likely to continue to highlight failings which become the subject of supply chain disputes or related business issues, such as project disruption, withdrawal of funding or debarring from public tendering.

Mayers: The current landscape certainly indicates a potential rise in disputes given the sheer number of concurrent issues being faced. In terms of trends, that will ultimately depend on the jurisdiction which the parties have chosen to govern their contract. The ability to seek redress where the parties have agreed a transfer of risk for nominated or novated supply chains which subsequently fail, through insolvency or contractual default, is likely to be a frequently arising issue. In jurisdictions which provide parties with a right to renegotiate to preserve the economic bargain, or to seek relief from economic hardship more generally, there is likely to be a significant increase in such cases. In jurisdictions without a similar legislative framework, there is likely to be an increase in cases testing the scope of the parties' drafting on key concepts such as force majeure, price escalation, insolvency and termination provisions.

Gurun: With strategic planning, proper risk allocation and well-managed operations, I believe we will see fewer supply chain disputes. The world is again transitioning to a new way of working. Few of us welcome change but change often does improve results. For example, Asia is not the only hub for competitively priced manufacturing; new hubs are developing around the world. But we have much to learn from the success of Asia. The North American Free Trade Agreement (NAFTA) and other regional trade groupings must develop the infrastructure and collaborative arrangements to foster innovation for more effective supply chains. Successful risk management will require a greater diversity of sources and more work to develop and manage this diversity. The most valued human capital will be those people who have lived and worked in different cultures and industries and can draw on their experiences by analogy to resolve issues. To succeed in this more complicated supply chain environment, I believe that supply chain issues can be diminished by careful planning and constant re-evaluation and reallocation of the risks companies face. Agility is key. ■

This article first appeared in the June 2023 issue of Financier Worldwide magazine. Permission to use this reprint has been granted by the publisher.