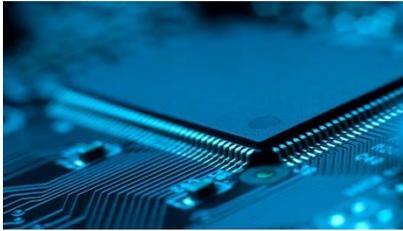


Industrial Compass for General Counsel

Managing Risk from the Semiconductor Shortage

Why is this an important issue for Industrial companies?



The shortage of semiconductor chips is one of many current examples of the wider issue of supply chain resilience. Intel's CEO Pat Gelsinger has stated that the current semiconductor shortage will persist until at least 2023. The semiconductor industry is responding but shortages are expected to continue for some time. European and US governments have plans to invest in the market to balance out the supply chain. However, it's unclear when these investments will result in increased production capabilities.

Business pressures: why companies should consider reviewing their strategy



Major disruption to global supply chains which is impacting customer and supplier relationships already strained from COVID-19. This could result in disputes and companies **reviewing minimum/maximum volume commitments** and the **force majeure clauses** in their contracts to determine if these may provide relief if the suppliers fail to meet delivery expectations or are forced to incur additional costs to do so.



Suppliers **facing costs** resulting from shortages –with costs attributable to tariffs, unanticipated raw material cost escalations, freight expedites, return costs, overtime, etc.



Other sectors relying on similar chips should be viewed as **'supply competition'**. Foundries are serving businesses across different industries and the threat of supply competitors gaining capacity may be greater than direct competition.

Potential impact for Industrial companies



More rigorous policing of contractual minimum and maximum volume commitments to products in a supply chain, including obligations concerning 'burst' capacity and automatic contract renewals. Parties should pay close attention both to existing arrangements but also levels of flexibility when contracting.



Ongoing monitoring of the potential for both raw material cost increases, as well as trade tariffs and added cost through cross-jurisdictional border controls. Consideration of introducing cost-sharing mechanisms for potentially foreseen scenarios.



Renewed focus on force majeure clauses in a COVID-19 climate, mapping supply chains, and the related risks. The competing positions of buyer and seller will have more bearing and force majeure clauses will be more heavily negotiated as standard practice, to allocate the risk between the parties.



Potential investigations given the impact the shortage are having on multiple industries, and the subsequent investment made by the US and others, this is a market international governments and authorities are following closely and suppliers may well find themselves subject to further scrutiny, particularly if they are receiving complaints from affected purchasers.



General Counsel awareness

Board-level awareness of Semiconductor shortage and direct involvement in determining the response is critical.

Threat intelligence can help organizations become more proactive, focused, and preventative to take control of risks in a unique and positive way. Considering the issues below can help leaders quickly identify gaps in the current supply chain strategy and encourage an organization-wide approach to secure the future of their business

- Learn current time to failure and time to recover – important to **understand the impact disruptions will have on time** – consider stress test to assess risks in the supply chain
- Understand **what chips you use and where they come from** – a record of multi-tier suppliers can help identify trouble areas in the supply chain, such as where are the concentration risks
- **Rethink supply networks** and co-location. Companies should give serious consideration to not only multi-sourcing strategies, but also to a hybrid of in-sourcing and out-sourcing
- Accept that there may be **limited immediate options** to address today’s shortage besides adjusting orders, production schedules, and prices. Focus on future planning
- **Understand interests in the automotive industry.** The industry has some of the most stringent requirements in their qualification process
- **Time’s up for just-in-time** – built on the just-in-time principle, semiconductor supply chains are experiencing that working in this manner can have a devastating impact

Questions for General Counsel to use in the Boardroom



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| <p>1 What steps can we take to ensure a more stable and resilient supply chain? Can this be achieved through strategic changes to our procurement model and/or contract changes?</p> | <p>5 How attractive are we to our suppliers?</p> |
| <p>2 Should we consider moving away from sourcing in Asia and analyzing cost versus risk mitigation benefits from shifting our supply chains to other countries?</p> | <p>6 Should we digitize our supply chain if not already done so, to have real-time visibility into any potential or existing disruptive factors? This would require data from all sub-suppliers in our supply chain – which could cause us issues?</p> |
| <p>3 Should we consider partnering with other businesses for the delivery of goods or the production of products? Must we start seeking out joint ventures or a merger/acquisition of trading divisions?</p> | <p>7 What protection do insurance policies afford us? If so, how much cover is afforded?</p> |
| <p>4 Can our business financially continue with its current workforce levels? If not what levels of redundancies/ specific plant closures are required?</p> | <p>8 Have we reviewed our key contracts and considered what legal protections need to be inserted for future contingency planning?</p> |

What actions should General Counsel consider



Companies can build supply chain resilience into their planning and manufacturing processes by evaluating these key considerations. Focus on mapping your supply chains and the related risks – then for future contract negotiations and commercial documents to allocate the various risks accordingly:

- if a shipment was already in transit, who pays for costs to return those parts when there was no one on-site to receive them?
- situations where one plant in one location had to be closed, but other manufacturing facilities had the capacity – who pays for the costs to tool up and ramp up at an alternative location? Who pays for employees’ overtime?
- reviewing minimum/ maximum volume commitments and the force majeure clauses in their contracts to determine if these may provide relief if the suppliers fail to meet delivery expectations or are forced to incur additional costs to do so.

Seek flexibility in minimum/ maximum volume commitment obligations and arrangements for bust capacity situations. Investigate the resilience of suppliers in being able to deliver/ be financially accountable. Re-examine standard force majeure provisions to ensure that they are properly tailored to (i) encompass past force majeure events and events that may cause disruptions in the future, (ii) focus on rights and obligations depending upon whether the company is the buyer or the seller, and (iii) allocate risk, including series of costs that may not have been previously spelled out in the contract, like freight expedites, return costs, overtime.

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