LITIGATION MINUTE: LEGAL CONSIDERATIONS FOR SUPPLY CHAIN DISRUPTIONS

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U.S. Complex Commercial Litigation and Disputes Alert

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WHAT YOU NEED TO KNOW IN A MINUTE OR LESS

The COVID-19 pandemic has disrupted supply chains around the world requiring many companies to adjust operations and their business. Supply chain litigation has not erupted as companies have largely been forced to find commercial solutions, recognizing that there is little to gain from litigation when they are still dependent on those same suppliers to help them tread water and stay afloat. However, as the wake expands and losses are crystalized, companies should re-evaluate their contractual rights and defenses in the event litigation becomes more common or appealing. Now is also a good time for companies to evaluate their contracts to ensure they contain adequate protections for future supply chain shortages or disruptions.

Potential contractual claims

Many supply contracts require the delivery of goods by a certain time. If the contract specifies delivery dates and quantities, or notes that they are “of the essence,” then strict compliance with the terms is typically required and failure to comply constitutes a breach of contract. If, however, the parties have routinely permitted partial shipments or delayed shipments, or if the contract permits them, then the course of performance or terms may not require strict compliance, and a breach of contract action may not be viable. For these reasons, contracting parties should consider the specific terms of their contract and the historical course of performance while evaluating a breach of contract action.

Potential contractual defenses

Force Majeure provisions have rightly received a lot of attention recently, as they are common contractual provisions that excuse performance under certain enumerated circumstances. All jurisdictions require the force majeure event to be specifically enumerated or to fall within a catchall provision. Courts generally construe force majeure provisions narrowly and general phrases in a force majeure provision, including “other similar events or causes” will be confined to things of the same kind or nature as the particular matters mentioned; whereas, “any other events or causes” may not be read as narrowly. Performance must be impossible (economic hardship is typically insufficient), although some courts have recognized commercial impracticability in rare cases. Some jurisdictions also require the event to be unforeseeable and outside of the breaching party's control. With respect to supply chain disruptions arising from COVID-19, a breaching party will have the strongest defense if its contract expressly lists a pandemic, epidemic, or supply shortage as a force majeure event. Other express events that have been successfully invoked include “government orders,” and “natural disasters.”

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If a contract does not contain a force majeure provision or if the provision does not include the type of event causing the breach, the common law can step in to fill the gap under the defenses of impossibility or frustration of purpose. However, in some jurisdictions, the existence of a force majeure provision could render the invocation of impossibility or frustration of purpose more difficult as courts will read the contract in its entirety and look for certain risk-shifting provisions to determine if the event was, in fact, unexpected or if it could have been, but was not, enumerated in a force majeure provision.

Commercial considerations

Contracting parties should continue to work together to find reasonable commercial solutions to address any supply chain disruptions and resulting contractual breaches. The contract may expressly require it. Further, contract law imposes a duty to act in good faith and attempt to mitigate losses. Any claims or defenses are also likely to be viewed through the lens of whether the party's actions were commercially reasonable under the circumstances. As a result, even if litigation does become more common or appealing, parties should continue to communicate and work in good faith to resolve issues, as these steps will be beneficial for all parties, and all claims and defenses in the event of eventual litigation.

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