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SUPPLY CHAIN DISRUPTION: PROTECTING YOUR BUSINESS

Disruption in supply chains poses a threat to commodities businesses. In this article, we suggest some ways to protect your business and minimise any damage caused.

Problems with supply chains have hit the headlines lately - and not just because of the pandemic. The recent severe weather conditions in Texas have had a significant impact on petrochemical production in the region, a major hub for the global chemicals business. It is anticipated that global supply chains will be affected for months. The blockage of the Suez Canal is also likely to impact commodity supply chains, especially against the backdrop of existing pressure on the global freight and logistics industries caused by the pandemic. How can affected commodities businesses respond?

Identify the exposure

What are the specific risks you face? Are you a chemicals trader with a contractual commitment to supply a product you cannot now source, or which is only available at a cost that will make the contract unprofitable for you? Are you an FOB buyer with a nominated vessel now stuck in the queue at Suez which will therefore miss the delivery period under your purchase contract?

Typically, disruption to supply chains can give rise to the following risks. Consider which apply to your contracts so that you can be focused in your response:

- Price rises – where a commodity is in short supply.
- Cost increases – for example, a rise in freight or storage costs.
- Supply shortages – inability to fulfil contracts creating a risk of default.
- Delays – including both delays in a vessel arriving, or in the cargo being available.
- Counterparty risk – counterparties seeking a way to exit unprofitable contracts may choose not to perform, or may try to find an exit route from the contract, for example by claiming force majeure.
- Cross-defaults – if you or your counterparty default on a key contract, this can trigger cross-default clauses in other agreements.
- Insolvency – in a trading counterparty or a vessel provider.

Prioritise

A number of your contracts are likely to be affected by the disruption. Of these, identify which are of the highest value or significance to your business. This will allow you to allocate resources appropriately.

Be proactive

1. Check each contract. This will help you to identify where you and your counterparty are most exposed and what, if any, contractual protections are available to you. Consider in particular clauses covering delivery, freight and storage cost allocation, price review, force majeure, events of default and cross-default, material adverse change and insolvency.
2. Contact your counterparty. Commercial renegotiation is often less costly than litigation. Make sure any renegotiation or settlement is recorded in writing and check other contractual terms which may affect it, including no waiver, entire agreement and no oral modification clauses.

3. If supply is the problem, can you source an alternative supplier? If so, consider how and when you can take this option without defaulting on your current supply contract.
4. Some claims will be inevitable, either brought by you or against you. Keep good contemporaneous records and evidence of the circumstances surrounding the claim and of your loss. This will put you in the best position to negotiate a settlement or pursue/defend a claim.
5. Bear in mind that you may have an express obligation to mitigate your loss in some circumstances, for example in relation to a force majeure claim. Record in writing the decisions you make and the steps you take to mitigate the impact of the disruption on your contract.
6. If the contract contains a force majeure clause, consider whether you (or your counterparty) might be able, or likely, to trigger it. What will the impact be on your other contractual commitments?
7. Check the notice provisions in your contract. Failure to comply strictly with notice provisions can jeopardise the success of a claim, or of a defence to non-performance. This is a particular issue in relation to force majeure claims, where parties who may have an otherwise strong force majeure claim fail to observe the notice provisions in the relevant clause of the contract, with the result that they invalidate their position.
8. Check your insurance policies to see whether you have cover available and what obligations you may have in relation to documentation, notice and mitigation.
9. If the contract contains an event of default clause, evaluate the impact of triggering it, particularly if you have other contracts with the same counterparty, or if you are in a contractual chain. Is it the best option? Would continuing to perform be preferable? If so, how can you minimise the risk of continuing with performance, for example by requiring security?
10. Cash flow issues can create financial problems very quickly. If you believe a counterparty to be at risk of insolvency, what are your options – and what would be the best outcome for you? Does your contract contain an early termination clause which could be triggered by an insolvency? Would that help or harm you overall? Do you have security available, or the right to require it?

Conclusion

Prompt and strategic action can help to protect your business against the impact of supply chain disruption. HFW is able to advise in more detail on any of the issues covered in this article.

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