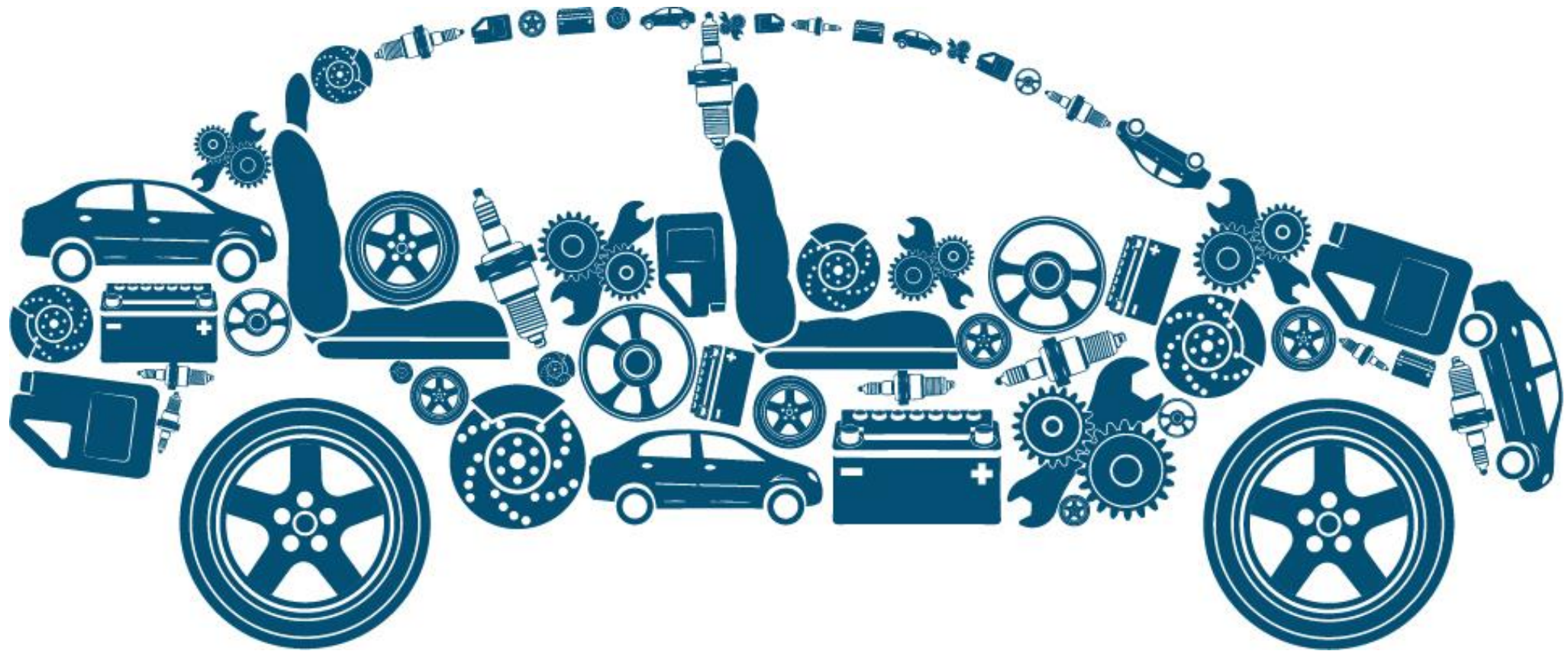




Big Three Automakers Suspend Operations: The Legal Effects on the Supply Chain

Sheldon Klein / James Bruno / Jennifer Dukarski



The Contractual Consequences of the Shutdown

Sheldon Klein / 248.258.1414 / Klein@butzel.com

Do the OEMs have the Right to Stop Buying because of COVID 19?

- If under a Requirements Contract, YES, for several reasons
 - Under a Requirements Contract, if a buyer has no good faith requirements, it may purchase nothing
 - UCC 2-306(1): A term which measures the quantity by the . . . requirements of the buyer means such actual . . . requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior . . . requirements may be tendered or demanded.
 - Even if the OEM had an obligation to purchase. COVID 19 may be a *Force Majeure* event, which would excuse any failure to purchase
 - *Jim Bruno will discuss Force Majeure*
- We discuss OEMs, but the same would be true of any buyer

Must the OEM honor its firm releases?

Answer will depend on the specific language of the contract, but typically the OEM buyer has the right to defer any specific delivery, so “firm” does not mean “firm date”

FCA Buyer may change the rate of scheduled shipments or direct temporary suspension of scheduled shipments, neither of which shall entitle Seller to a modification of the price for goods or services covered by this Contract.

Ford The Buyer may also make changes to its order . . . includ[ing] shipping date or time or place of delivery.

GM Buyer may change the rate of scheduled shipments or direct temporary suspension of scheduled shipments.

What if it is not a Requirements Contract?

- Not all industry contracts are requirements contracts, especially for non-production or commodity goods.
 - Example – you have agreed to purchase X barrels of lubricant for delivery on March 25.
- Unless your contract says differently, you are obligated to take and pay for those goods, unless you have a *force majeure* excuse.

What About my Contracts with my Suppliers?

- In general, your rights with your supplier is the same as your customer's rights with you
 - If you have a requirements contract with your supplier and your customer has zero requirements, then you have zero requirements for your supplier
 - But, if your customer has a force majeure excuse for not buying from you, that does not necessarily mean you have the same excuse with your customer
- One major qualification, if your contract with your supplier is different than and less protective of you than is your contract with your customer, you may be left holding the bag
 - One of the many reasons that your terms of purchase should make clear that your supplier makes to you the same promises that you make to your customer
 - Drafting these provisions is tricky and often poorly done
- Transparency is best practice, both legally and commercially; don't leave your supply base in the dark

Ramping Up and Ramping Down?

- You may incur a variety of costs to ramp down production, such as storage and maintenance costs
 - Subject to the contract, you probably can not recover those costs
 - Stated differently, if the customer has to right to stop buying, it is not obligated to pay for your incidental costs of ramping down.
- When the OEM resumes operation, you may not be able to ramp up production quickly enough to fulfill releases
 - Does your contract have lead time protection?
 - For example, FCA says: “[If] FCA US's releases. . . request a delivery outside of Seller's stated lead time (as set forth in the Order), FCA US and Seller will agree on a delivery time as proximate to FCA US's original request as is commercially reasonable.”
 - If not, you still may be entitled to schedule relief based on Usage of Trade / Course of Dealing
- What about costs of accelerated ramp up such as expedited shipping or shift premiums
 - Unclear
- You need as much information as possible; don't be shy about nagging your customer
 - Your suppliers need the same from you and you from them

Best Practices

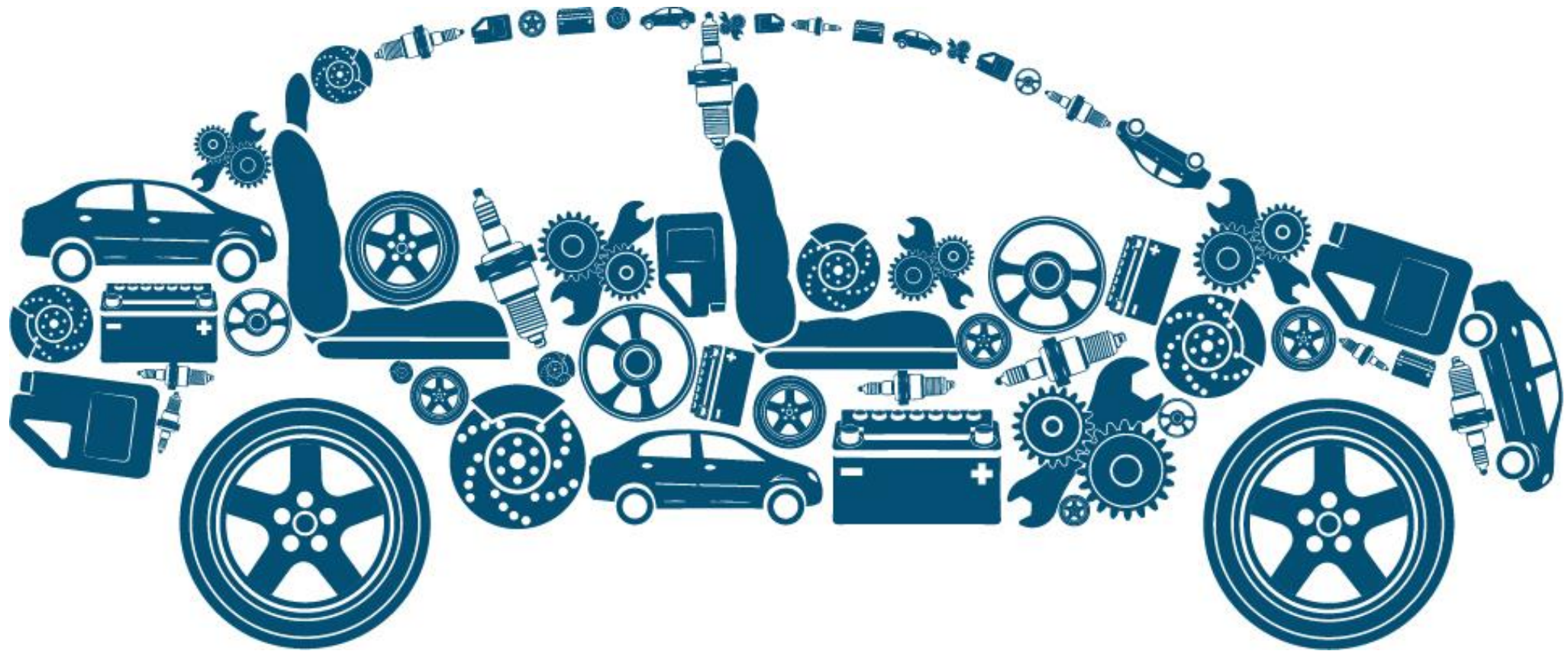
- Know your contractual rights and duties up and down the supply chain
 - Notice obligations
 - Financial obligations
- Provide and demand constant communication of current status and expected future developments up and down the supply chain – you need to know what your customer expects of you and your suppliers need to know the same
- Assess potential bottlenecks in ramping up production
- Address bottlenecks with your customers and suppliers, including addressing and agreeing on cost and schedule relief

Sheldon Klein

248.258.1414

klein@butzel.com

THANK YOU



Force Majeure 101 and the Big Three Plant Closings

James Bruno / 313.225.7024 / Bruno@butzel.com

Force Majeure

1. French term meaning “superior force” NOT USED in Uniform Commercial Code (“UCC”).
2. The UCC term is “impracticability” which is less definitive than “impossibility.”
3. But many U.S. and foreign contracts continue to use the term “force majeure.”
4. Because the UCC allows for freedom of contract, any analysis of excused or delayed performance requires:
 - a) First, review the specific force majeure clause in the contract;
 - b) Second, review of the UCC for (i) any “fillers” for “gaps” in the contract force majeure language; and (ii) any limitations of applicable law on the freedom of contract.

Question - Does a force majeure clause in an integrated contract exclude the application of UCC §2-615 clause or does the UCC supplement the force majeure clause? The answer is:

1. Not all contracts (Terms and Conditions) have a Force Majeure clause (e.g., FCA).
2. Common law supplements UCC, but does not supplant the UCC, UCC §1-103. If an integrated contract has a force majeure clause, will the common law concepts of impossibility, frustration, and/or UCC impracticability survive? Depends on various state statutory provisions and court decisions. Not clear in Michigan.

UCC §2-614-616 in Plain English

- If a force majeure event makes **delivery impractical**, delivery is excused, so long as:
 - Seller gives **timely notice**
 - If partial delivery is possible, Seller **allocates** among its customers in a fair and reasonable manner
 - If delivery is possible by changing the contractual **transportation or delivery methods**, the parties must accept “commercially reasonable” alternative.
 - Alternative practical methods of performance are employed.
- **If** the force majeure event is material or indefinite as to how long it may last, **Buyer may terminate**:
 - as to the affected deliveries; and
 - for installment contracts, the entire contract, if the delay substantially impairs the value of the contract
- Each party must consider in good faith the other party’s suggested alternatives (UCC-3-104).

More on “Impracticable” Delivery or Other Performance

- Burden of Proof on party claiming excuse.
- “Extreme and unreasonable difficulty, expense, injury and loss” or “Excessive” not enough, must be “positively unjust.”
- No “practicable” alternatives.
 - How much expense?
 - How long to do?
 - Investigate and document.
 - Must compare cost with effects of not providing alternatives.
- Sub-Supplier is at fault.
 - Mere sub-supplier default without its own sub-supplier FM excuse is insufficient.



Contract Terms Control

- Contract frequently modifies UCC and common law rules.
- UCC 2-615 “Subject to contractual modification ...”
- Read the contracts.
 - Your Customer’s Terms.
 - Your Terms.
 - Your Sub-Suppliers Terms.
- Read them again.
- What should you negotiate in future contracts?
- What changes should you make in insurance coverages? What changes are your carriers making to current policies?

Selected Key Issues to Examine in Contracts

- Is the event at issue listed in the contract as an included or excluded FM?
(All OEMs except Nissan require absence of fault/negligence)
- What is the Incoterm and where is your delivery point? Ex-works or DDP Buyer makes a big difference in what mitigation and related costs Buyer must assume.
- What type of notice is required and when?
- What law applies (state, country, UCC, CISG)? Canadian, Germany and Mexican law can make a difference. Send me an email if you want our Client Alert on the Chinese law of force majeure.
- What other obligations are imposed?
 - various types of risk mitigation (bank of parts, alternate source)
 - Allocation
- What mitigation effort is specifically required? “Reasonable,” “Diligent” or “whatever it takes”?
- What rights does the Buyer have to (a) cover by purchase from others and charge for cost of cover and/or (b) terminate?

Honda Terms, Section 4.8 (part 1)

Either Party may suspend performance during an "Excusable Delay", which shall mean any delay not resulting from the fault or negligence of the delayed Party and resulting from acts of God, acts of war, restrictions, prohibitions, priorities, or allocations imposed by governmental authority, acts of the other Party hereto, embargoes, fires, floods, winds, earthquakes, epidemics, unusually severe weather, and delays of similar natural or governmental causes.

Honda Terms, Section 4.8 (part 2)

Excusable Delay **does not include** any strike, lock-out, shortage of labor, lack of or inability to obtain raw materials, fuel, or supplies (unless caused solely by priorities, restrictions, or allocations imposed by governmental authority), or other industrial disturbance **unless Seller is using its best efforts to cure the cause of such delay and Buyer has approved Seller's detailed plans for assurance of timely and conforming delivery(ies) in the event of such specific delay and Seller is diligently implementing such plans.**

No time to review all OEM Terms – do you have the latest OESA OEM North American Production Purchase Order Contract Terms and Conditions Comparative Analysis?

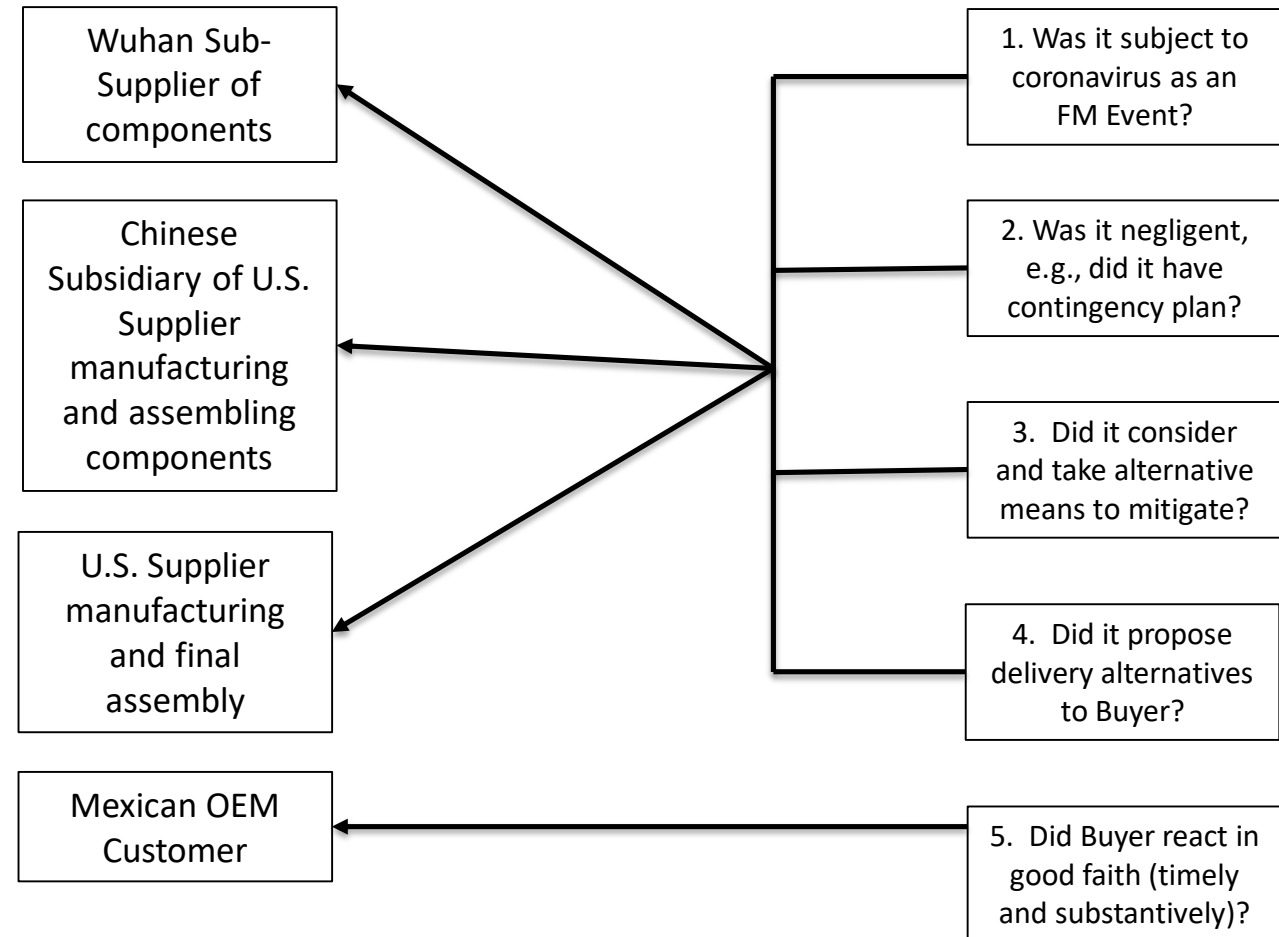
Coronavirus As a Force Majeure Event

- Under UCC 2-615 and most General Terms and Conditions of Purchase the coronavirus is likely to be a force majeure event, although do not expect Buyers to voluntarily agree unless possibly epidemic, quarantines, or government orders are specifically referenced.
- But, what about “ejusdem generis” – A list is meant to exclude all similar causes, but is there a “basket” phrase (e.g., “all similar events”)?
- Declared a Public Health Emergency of International Concern by World Health Organization January 30, 2020.
- Ask for declaration of force majeure from China Council for Trade Promotion has issued over 1,600 force majeure certificates to Chinese companies.
- Does UCC § 2-615 supplement a force majeure clause?
- Generally - Sellers should act as though there has been an FM event and give notice, accepting the risk a Buyer may terminate for a declaration of a FM event of unknown length.
- But, assuming it is a FM event, steps must be taken and proofs provided to Buyers to take advantage of it.
- Chinese courts may issue an advisory opinion, as it did in SARS, after epidemic is over, but perhaps not binding on US Buyer applying U.S. law.
- Do you have or need an epidemic control plan?

Must Evaluate What Was The Effect and How It Was Addressed At Every Tier

Query – Can you trace back the final delay at delivery to OEM to the original FM without any subsequent intervening proximate cause such as a failure to mitigate?

Note – Foreign contract law may affect duties of Chinese sub-supplier, but likely not the obligation of U.S. supplier to OEM.



Who Bears the Costs?

- Two models
 - Binary or Equitable
- Binary
 - If no excuse, supplier liable for damages (breach).
 - If excuse, costs stay where incurred, whether or not alternative performance possible.
- Equitable → Fair allocation – some civil law and Arabic law jurisdiction may permit price increases, particularly in construction.
- U.S. → Binary.
- DISCUSS AND TRY TO REACH AGREEMENT
- Additional relief possibly available on your costs if the Chinese sub-supplier were a customer designated sub-supplier named in the P.O. as sole source.

OEM Closings Relationship to Force Majeure

- Force majeure is a superior force that prevents practical performance.
- Current situation does not prevent OEM from purchasing and using or storing.
- Closings of Big 3 is result of agreement with unions and concern for workers safety.
- There is no union walk out.
- Closings at non-union plants is concern for workers safety.
- There is no government order to close, except possibly at Tesla.
- There is a real threat to workers health, but there is no proof if could not be addressed through other means while production continues.
- Thus, the Big Three would have a difficulty proving a force majeure event.

How to Characterize the Closing

If the closings are not force majeure, what are they?

1. Is this any different for suppliers than change-over or Christmas vacation?
2. Yes, (a) it is unscheduled, (b) there are additional costs and risks, and (c) no definitive end.
3. There is no claim of FM or impracticability by OEMs. They do not want to admit coronavirus is an FM impracticability as that could be an admission if a supplier claims FM. For example, GM §27 reads in part:

“..., or Buyer is unable to accept delivery, buy or use, the goods or services covered by this Contract, directly as the result of an event or occurrence beyond the reasonable control of such party, without such party's fault or negligence”
4. Instead, OEMs claim rights under capacity and release provisions in Ts&Cs and other documents.
5. OEMs could also claim rights under termination for convenience.

What Insurance Coverage May Apply?

1. Different add-on riders coverages such as Business Interruption, Contingent Business Interruption (“CBI”), or Civil Authority may be in force which covers lost income.
2. What are specific inclusions and exclusions?
3. Generally direct physical damage to the insured’s property, or supplier’s property (for CBI) required to trigger coverage.
4. But, an actual viral infection (or well-based fear?) may be a physical damage.
5. A closing caused by a sustained order of limited access may trigger coverage under a Civil Authority rider.
6. Check your commercial policy for riders.

Best Practices When Facing a Force Majeure

1. Have a plan (know your supply chain), implement Risk Mitigation Plan.
2. Review all contracts for applicable force majeure provisions and contact counsel with any questions as to whether an FM event has occurred or who is required to pay costs. The answer will generally be that, yes, an FM event has occurred, and the supplier must pay the costs of any reasonable mitigation including premium freight. But, that may not always be the answer depending on the terms of the contract and available alternative means of performance.
3. Insist on disclosure of realistic inventory and production volumes from customers and suppliers and the effect of non-supply.
4. Work together with customers and suppliers to assess inventory on hand, whether there is a bank of parts that can be accessed, whether there are other manufacturing lines available at different locations, and the company's and its supplier's allocation plans of what parts are available. Note that a "fair and reasonable" allocation across customers is required under UCC § 2-615(b), but some customer terms may require they be favored.
5. Ask customers what assistance is being provided to suppliers as to logistics and cost sharing. Work with your own sub-suppliers on possible alternatives.

Best Practices When Facing a Force Majeure (Continued)

6. Consider offering, any parts in inventory that may have been built under earlier design levels. This would also reduce the OEM's balancing out costs that may be claimed.
7. Investigate all of your alternative methods of delivery or other impacted performance, including supplying from other countries or sub-suppliers. Present all alternatives and emphasize buyer's obligation of good faith under UCC § 1-304 in considering alternatives.
8. Confirm that the notice to customer's requirements under the contract and UCC 2-616 for an FM event have been met. Note that the UCC and some force majeure provisions in customer terms have time limitations on reporting the FM event. This step should be completed as soon as possible.
9. Obtain and provide to the customer as much information about the specific force majeure event and any claim for cost reimbursement as possible, including the timing, the number of impacted parts/facilities, and when the force majeure event is expected to conclude, and alternatives that are being investigated. Continue to supplement all notices as additional information becomes available.

Best Practices When Facing a Force Majeure (Continued)

10. Consider whether and when an alternate supplier can be ramped-up.
11. Be aware of the other party's rights (customers and sub-suppliers) if force majeure is invoked, which may include the right to terminate and source from an alternate supplier or to terminate after a certain period of time.
12. Contact all company suppliers that may be impacted and request a written impact statement.
13. Check with your insurance agent as to whether there is coverage under a business interruption or other policy.
14. Be sure that you are always exhibiting good faith in trying to rationally resolve the issue in good faith to mitigate the damages and document your efforts.
15. If the contract provides for law of a jurisdiction outside the U.S., obtain guidance based on the law that jurisdiction which may be more seller friendly.
16. Make any payments directed by a customer which are believed to be not your responsibility "under protest."
17. Do not do anything you believe is not your responsibility without a demand from your customer.

A Notice Template

This is only a sample and must be modified for each customer based on its force majeure clause.

| ¶ # | Text / <i>Instruction</i> |
|-----|---|
| | <i>Use ¶¶ 1 or 2, as applicable. ¶ 1 if direct force majeure event, ¶2 if indirect (supplier) event</i> |
| 1 | {COMPANY NAME} will be unable to supply {CUSTOMER NAME} with {SOME / ALL} of its requirements of {INPUT} as a result of the following event constituting force majeure, impracticability, impossibility, and/or frustration of purpose: {BRIEFLY DESCRIBE FORCE MAJUERE EVENT}. |
| 2 | {COMPANY NAME} has learned that its supplier of {DESCRIBE INPUT} will be unable to supply {COMPANY NAME } with {SOME / ALL} of its requirements of {INPUT} as a result of the following force majeure event: {BRIEFLY DESCRIBE FORCE MAJUERE EVENT}. {COMPANY NAME} requires {INPUT} in order to manufacture {CUSTOMER PRODUCT}. As a result, we will be unable to satisfy {SOME/ALL} of your {PENDING &/OR EXPECTED} orders for {PRODUCT}. |
| | <i>Use ¶¶ 3 or 4, as applicable. 4 is preferable, if there is a reasonable basis for the estimated duration.</i> |
| 3 | We cannot currently estimate how long this supply disruption will persist. We will keep you advised as we obtain more information. Our current plan for each of the potentially affected product is included on Exhibit A. Please advise us of your plans to address the issue and any suggestions you may have on how we can work together to mitigate any efforts. |
| 4 | We currently expect the supply disruption will persist for approximately {INSERT DURATION}. We believe this is a reasonable estimate, but the actual duration may vary for many reasons. We will keep you advised as we obtain more information. |
| | <i>Use ¶ 5 if allocation is possible</i> |
| 5 | {COMPANY NAME} estimates it will be able to produce approximately ___% of its {NORMAL/HISTORICAL/SCHEDULED} production of {PRODUCT}. {COMPANY NAME} believes this is a reasonable estimate, but actual production may vary for many reasons. We will keep you advised as we obtain more information. {COMPANY NAME} will allocate its supply of the {PRODUCT} among its customers in a fair and reasonable manner. |
| | <i>Use ¶ 6</i> |
| 6 | We assure you that we are attempting to minimize or eliminate the supply disruption. Please contact _____ if you have any questions regarding the anticipated impact of this force majeure event on {COMPANY NAME'S} supply of {PRODUCT} to {CUSTOMER} or have other questions or suggestions regarding this difficult situation. |

James Bruno

313.225.7024

Bruno@butzel.com

THANK YOU



BUTZEL
LONG

The Defense Production Act

Jennifer Dukarski / 734.213.3427 / Dukarski@Butzel.com / @Jdukarski

Big Three Automakers Suspend Operations:

The Legal Effects on the Supply Chain

THE DEFENSE PRODUCTION ACT

These are Challenging Times...

- During World War II, the Arsenal of Democracy mobilized. In 1950, at the start of the Korean War, the Defense Production Act (DPA) was passed to provide for the civil defense and to prepare for war mobilization.
- The DPA matters today because:
 - Its priority and allocation powers may affect your current business
 - Its productive capacity and supply authorities could provide compelling federal benefits to businesses working with the federal government in the COVID-19 response



Trump Invokes the Defense Production Act

- On March 18, 2020, President Trump announced that he will consider using the Defense Production Act (DPA) to respond to the critical shortages of personal protective equipment and medical equipment including masks and ventilators
- The Purpose of the DPA: “To promote industrial resources preparedness in the event of domestic or foreign threats to the security of the United States.”



“This would ensure we have the materials we need at the ready, rather than wait for disruptions in the global supply chain to subside ... I view it -- in a sense as a wartime president.”

What is the Defense Production Act?

Section 4512 (50 U.S.C. § 4512):

- Authorizes the President to **require acceptance and performance** of contract or orders and to allocate materials, services, and facilities as he deems necessary or appropriate to promote the national defense.
- The President cannot use the powers to control the general distribution of materials in the civilian market unless he finds (1) that material is **scarce and critical** / essential to the national defense, and (2) that **requirements cannot be met** without creating a significant dislocation of the normal distribution channels

What is the Defense Production Act?



Section 4512:

- Allows for the **prevention of hoarding** beyond the reasonable demands of consumption. The President can publish the amount deemed reasonable.

Section 4513:

- Penalties for failure to comply can include **finest of \$10,000 and one year imprisonment.**

Section 4514:

- **Wage and price controls** must have the prior authorization of a joint resolution of Congress.

What is the Defense Production Act?

Section 4517:

- Allows for the strengthening critical industrial components of the U.S. that may be essential for the national security strategy including maintaining **reliable sources of supply** and restricting solicitations accordingly.

Section 4531 - 4534:

- Allows the President to **provide economic incentives** to secure domestic industrial capabilities essential to meet national defense and homeland security requirements.
- Allows the President to authorize the **guarantees of loans or the provision for loans** by private institutions for the creation, maintenance, expediting, expanding, or restoration of production.

How Could the DPA be used? Personal Protective Equipment (PPE)

- Under Title I, the President could prioritize domestic production of PPE to ensure sufficient national stockpiles, and allocate them according to the needs of the emergency.
- Under Title III, the federal government could use authorized incentives to expand domestic capacity for PPE manufacturing to meet the needs of the emergency.
- Under Title VII, the President could establish voluntary agreements with private industry—which might normally be subject to anti-trust statutes—to coordinate industry PPE production.



How Far does the Act go?

Can I be forced to produce?

Possibly, but unlikely. Under *U.S. v. K&F Packing and Food Corp.*, the DPA is constitutional but manufacturers haven't been asked to stray from core products.

Will the government indemnify me if a product harms others?

Probably not. In *Hercules Inc. v. U.S.*, the DPA did not provide the basis for an indemnification claim where the manufacturer produced the defoliant known as "Agent Orange."

Will I be compensated by the government for the loss of other contracts?

Probably not. In *Kearney & Trecker Corp. v. U.S.*, the government required a manufacturer to expedite delivery of a machine which frustrated a sale to third party. The court found that there was no "taking" under the just compensation clause of the 5th Amendment nor of the third party contract. It was merely a "frustration of expectations."

Big Three Automakers Suspend Operations:
The Legal Effects on the Supply Chain

A POSSIBLE VISION OF A DIVERSIFIED FUTURE

When General Motors becomes General Ventilators

This potential future could leave us in a “new normal” where diversification into the healthcare field remains...

- Will you have a role in the new, diversified supply chain?
- Will OEMs ever restore 2019/2020 production levels?



Traditional Legal Issues Are Continuing

- Intellectual Property Disputes
- State Consumer Protection Acts
 - Price Gouging
 - Deceptive Advertising
 - Unfair Competition

Volunteers 3D-Print Unobtainable \$11,000 Valve For \$1 To Keep Covid-19 Patients Alive; Original Manufacturer Threatens To Sue



(Mis)Uses of Technology

from the *patents-are-more-important-than-patients* dept

Tue, Mar 17th 2020 1:35pm – [Glyn Moody](#)

Techdirt has just written about the extraordinary **legal action** taken against a company producing Covid-19 tests. Sadly, it's not the only example of some individuals putting profits before people. Here's a story from Italy, which is currently seeing **more new coronavirus cases and deaths** than anywhere else in the world. Last Thursday, a hospital in Brescia, in the north of Italy, needed supplies of special valves in order to use breathing equipment to

help keep Covid-19 patients alive in intensive care (**original in Italian**). The manufacturer was unable to provide them because of the demand for this particular valve. The Metro site explains **what happened next**:

Michigan AG sends cease and desist letter to Menards for price gouging during coronavirus (COVID-19) outbreak

18 complaints received

If Diversifying, Be Prepared

- Intellectual Property
- End User Liability Risks
- Contractual Risks
- Regulatory Requirements



Jennifer Dukarski

734.213.3427

Dukarski@Butzel.com

@JDukarski

THANK YOU



BUTZEL
LONG

© Butzel Long 2019

Q&A Period

Sheldon Klein / James Bruno / Jennifer Dukarski