

Supply Chain Risk – What Does the Contract Say?

Posted by [The ALS Group](#) on Aug 3, 2020 12:43:13 PM



As companies think about their supply chain and the risks that are inherent with that area, a good place to start is with your contract terms with the supplier – what are the terms you want? What are the terms you have agreed to?

With the unsettling state of affairs of the world today, a manufacturer or distributor has to be properly vetted and the terms of supply carefully considered. What is an acceptable delay or non-delivery?

What is that “risk” going to cost the company? Will a component part be missing and the whole product cannot be shipped/sold? Will the missing piece cause loss of revenue? Loss of a distribution point? What if the person you are sending this widget to imposes penalties for non-delivery? What if they “sell” your shelf space? Will you get that back? Tailor your vendor’s contracts so that it works to mitigate these considerable risks for your company as best as possible.



The “good old” Force Majeure clause is a minefield for ways to avoid obligations – approach it very carefully and by all means, pull it apart – it usually will contain insurable and non-insurable risks including:

- Physical incidents, such as an act of nature
- Pandemics
- Breach of intellectual property rights
- Breach of IT/data security
- Reputation risks
- Terrorism, war, and geopolitical risks

Let’s also factor in what disaster recovery plans you are requiring your vendor to have, like cyber risks, fire/flood/EQ/wind. Also consider your vendor’s tertiary suppliers – what recovery plan do they hold their supplier to? That tertiary supplier to you, could often have an event that would delay your supplier – the COVID-19 pandemic is a perfect example of this. Many of the manufacturers in the Far East shut down, they could not ship their product to the US supplier, who in turn could not get it to you.

With a multitude of supply chain risks companies’ face, proper contract risk transfer is critical to a business’s ability to properly retain or mitigate risk. When contract risk is identified and quantified, property risk and liability issues can be mitigated through strong indemnity and insurance provisions. As part of your company’s strategy, doing an assessment of the risks posed by your supply chain is the best way to combat potential losses due to its delicate nature.

Having a resilient supply chain should be a top priority for any organization. Here is what we would suggest you start with:

- Work with your vendors to negotiate favorable and clear terms in your supply contracts and understand what risks your company is comfortable retaining and what risks must be transferred to vendors.
- Look at the language that indemnifies you from losses that your vendors are responsible for, and that also, transfers risk away from your business.
- Be very “stingy” with granting limitations of liability (“LoL”) and Force Majeure provisions as these provisions, together with the contract’s indemnity language and insurance provisions will be the critical basis of your protection.
- To ensure these provisions “mean something”, you should always collect satisfactory evidence of insurance including not only a certificate of insurance (“COI”) showing coverages and limits required, but also the policy forms listing, additional insured, primary and non-contributory and waiver of subrogation endorsements – these will matter significantly in case a loss or claim arises.

Contracts and policies need expert negotiations, not just generic copied and pasted language. Protect your business from supply chain disasters by ensuring that there is proper risk transfer in place. It’s not enough to have standard language to simply insert into any agreement, risk related provisions should recognize the commercial transaction and responsibilities. Recourse opportunities should be carefully considered.

The outsourcing of different parties throughout the production process increases the risks and exposures your company faces. By taking a proactive approach to risk management, your company can better



manage the financial impact from risks and develop mitigation strategies around them. The ALS Group offers a critical look at your company's contracts and policy provisions.

If you need more information on any of the topics covered in this blog, or need help with any risk related issues please contact [Nicholas Sica, CRIS, Vice President](mailto:nsica@thealsgroup.com), at The ALS Group, at 732.395.4263 or nsica@thealsgroup.com.

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