SJ LEGAL · INSIGHTS

Lessons learnt from the Corona crisis

Legal risk management of supply-chain issues in times of disruption.

Selected legal insight for the sporting goods and consumer goods sector.

DR. JOCHEN M. SCHAEFER · CONTRACTS / SUPPLY CHAIN

> *“Contracts are a risk management instrument. They can remain on the shelf in good times, but prove their quality and value if the tires become rough.”*

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OPINION

A guest article by Jochen Schäfer: The Covid-19 pandemic has thrown the European and world economy into a toxic cocktail of extreme turbulence and challenges, which are far bigger than those experienced during the 2008 financial crisis. While it may be too early to talk about the lessons that I have learned from the new crisis, I can touch on certain specific topics covered in the course of Jochen Schäfer's legal work for numerous individual corporate clients within and beyond the sporting goods sector. Here are some of the frequently asked questions relating to the disruptive effects of the recent corona-related shutdowns on existing supply chain relationships:

Which legal consequences does a temporary interruption or substantial delay of supply and deliveries have in terms of rendering it impossible for a commercial operator to observe existing contractual obligations for a certain period of time? Can a company e.g. request that agreements are to be adjusted, modified or even cancelled in the light of the present national/global pandemic crisis?

Is this a force majeure scenario falling into the traditional ”Act of God” categories and if yes, which rights does a brand have, which ones could be exercised and what will then be the legal consequences? Can a brand e.g. initiate back-up purchases and charge the additional cost to the supplier?

Which laws are applicable in commercial cross-border transactions in these cases? Do any recently enacted national mandatory laws and regulations overrule certain legal clauses in existing agreements? How should we deal with factual supply relationships if no contract exists between supplier and brand? Certainly, this is not the place to provide substantial answers to these questions, which very much depend upon the individual circumstances of each case. Yet, there is one important preliminary lesson that should remain in the focus of attention of the executive management of a company to help it survive this crisis: The lesson is the high value of writing a state-of-the-art contract which defines in a transparent

and clear manner (among other topics) the rules that shall apply in the event of foreseeable and unforeseeable impairments of performance on either side of a supply relationship. Given my long-term experience, I am still somewhat amazed that even major clients with long-lasting supply relationships are either not covered by written agreements at all in this area or only by (often conflicting) general terms of payment and delivery, or quite frequently, by agreements that show significant deficiencies when it comes to the treatment of the previously mentioned impairments. One concrete example shall illustrate this: In Germany (same as in numerous other countries) there is no specific statutory law in place that deals with a definition of force majeure scenarios and how these shall be handled. This leads to a highly complicated - and also in many regards ambiguous - application of general principles of civil law, with the risk that the commercial effects can be very negative for a company, or at least risky, since it remains uncertain, which rights can be exercised and which not. It has been my philosophy as legal advisor over the years to create solid and robust contractual platforms which will allow companies to operate in a fairly secure environment by mitigating risks, and this is not confined to Germany. International contracts in the supply chain management area show a specific international handwriting. Only a small portion of them are country-specific. To avoid misunderstandings: I am not in favor of overdoing and creating extensive and excessively long agreements. The risk assessment has to proceed from a practical point of view to determine where the main risk factors are by looking at the specifics of each individual commercial relationship and what the parties behind it represent. It makes a difference if we talk about established players which enjoy a significant amount of reputation, or about a newcomer on the market. These are basics, but they are quite frequently overlooked, according to my experience. Contracts are a risk management instrument. They can remain on the shelf in good times, but prove their quality and value if the tires become rough. Right now, even some long-term relationships are strained, or may even go sour. If they are terminated, clear contractual rules about the concrete consequences of such terminations can save substantial amounts of money. Again one practical example: To get into the repossession of existing inventory of unpaid goods upon termination of a supply relationship may become very cumbersome, if not impossible, in the event that no clear contract provisions exist to properly deal with such issues. For example, if a contract does not foresee that the terminated party being in possession of the remaining inventory is allowed access to the premises where such goods are stored, any unilateral attempt to enter the premises and get hold of the goods may well be interpreted as trespassing property in an unlawful manner. It could even expose the other party to sanctions and fines on the grounds of criminal law. In addition, another major advantage of a professionally worded contract is that its legal provisions are in most instances not challenged by judges and arbitrators - at least in the more civilized countries – unless they violate applicable laws. It is then sufficient to point with a finger at a certain clause instead of spending sometimes unreasonably high amounts of legal defense costs and binding company resources in litigation proceedings that will take several years to be resolved. Quite frequently, it is

not clear at all who will prevail in such kinds of disputes, not to mention all other negative effects and frustrations that such controversies might have for the business relationship as such. Preventive state-of-the-art contract management is part of the general risk management policy of a company, and in times like these it is clearly proven that the brands who have done their homework sufficiently in advance before major problems occurred are enjoying a significant competitive advantage. Again, in order not to be misunderstood: this does not imply that a company facing difficulties and disruptions in its supply chain should quasi-automatically trigger the contractual buttons and exercise all rights that it may have based on the related agreement(s) in place. Crisis management also requires solidarity to jointly weather the storm, without insisting in any event on a formal contract position. Yet, the fact alone that such rights exist may very well considerably improve the position of a contract partner to renegotiate the agreement, to adjust existing terms – even for a preliminary period – or to suspend/waive certain otherwise existing obligations. Several clients of mine have e.g. temporarily opened up new distribution channels, such as the trading of their retail customers on certain online platforms that were closed prior to the Covid19 crisis on the basis of existing selective distribution agreements. Others changed their distribution policies by creating their own B2C online stores, some with and some without the involvement of their retail customers. Further issues have arisen where a brand wanted to terminate the existing relationship with certain retailers after obtaining information about a financial deterioration of their businesses (some directly related to the shutdown of their retail stores, others indirectly because they were already facing financial difficulties prior to the current crisis). In these cases, I have been asked whether and under which conditions it would be possible to terminate the relationship with immediate effect, or if not, which prior notice periods would have to be observed for its ordinary termination. The above is only a facet of the corona-related topics that I am confronted with right now. Yet, it is also very encouraging and promising to observe that other clients of mine continue to pursue long-term distribution projects in spite of the current crisis, or are in a status where they are improving the quality of their contractual arrangements with suppliers and wholesale/retail customers. Another preliminary lesson I have learned is that commercial operators all over the world - regardless of whether they are suppliers, manufacturers (brands) or retailers - are dependent upon each other, and this is even true for end consumers. Without their willingness – or in many cases just their continuing financial ability to spend money on purchases of sporting goods – the corresponding substantial lack of demand cannot be overcome by all the commercial operators involved. Hopefully, the lifting of the still existing multiple restraints and the return of the freedom to travel in Europe will help to revive and rescue the business of the traditional operators in the sporting goods and outdoor sector. I am getting some very positive and particularly encouraging signals in this regard these days from my clients in the bicycle segment. Dr. Jochen M. Schaefer is a lawyer with his own practice in the Munich region. For many years, he has also been the Legal Counsel of the World Federation of the Sporting Goods Industry (WFSGI) and of the European Sporting Goods Industry

Federation (FESI). He provides legal advice to numerous reputable clients within and beyond the sporting goods sector by focusing on the areas of national and international distribution, IP and risk management, and on other operational issues. Dr. Schaefer can be reached at sj@sjlegal.de or on his cell phone at +49-15116407932.