

Overview

“In every year over the past several years, at least one company in twenty has suffered a supply-chain disruption costing at least \$100 million.” McKinsey Digital, May 14 2020

If you cast an eye at Google Analytics during the first weeks of the crisis, it probably wouldn't surprise you to know that force majeure trended high as a search phrase. It didn't take businesses long to realise that COVID-19 was going to significantly impact supply chains, and in-house legal teams (and law firms) were approached with queries around disruption and whether this pandemic would be considered as a force majeure or frustration event.

Now is the time, with the benefit of hindsight and lessons learned, to help your organization forge a new road ahead with regard to your procurement strategy. For many sectors this is no longer desirable, rather a critical business imperative.

We document below some of the key themes we believe it is helpful for in-house legal teams to consider at this time.

Why “resilience”?

Post COVID-19 recovery will place new demands on how businesses organize their resources. Some businesses (such as the retail and fast-moving consumer goods (FMCG) sectors) may embark on, or accelerate, end to end digitization programs and others may take the opportunity to tackle their Environmental, Social and Governance (ESG) agendas and embed sustainability in the enterprise. Nearly all businesses will examine virtual working and customer service patterns and re-assess their procurement and production strategies (and in particular whether key outsourced functions should be on-shored/near-shored). These “new dynamics”, on the one hand defensive – necessary to secure market share or shore up profitability – are also offensive – necessary to unlock internal efficiencies and target new and developing marketplaces.

Either way supply chain agility, and dynamic vendor management, will be central to the organization response. And the in-house legal team will be at the heart of this activity.

Supply chain resilience – scenario test

Traditionally, in-house legal teams have viewed their role as largely one of protecting the organization from risk. Post COVID-19, however, their role will also be accretive – key enablers of resilience and agility.

It therefore makes sense for General Counsel and their teams, to be part of the debate with regard to how their organization's procurement strategy should evolve at this time. Key to making this decision will be scenario planning (perhaps leveraging COVID-19 experience) with regard to the ease and cost of switching suppliers (and transportation methods). Teams will also need to consider scenarios beyond pandemics that could impact their

business – such as war, sanctions, economic or environmental disasters.

This exercise should be multi-disciplinary – linking procurement and IT teams with internal compliance, commercial and legal teams. The regulatory context will also be important – many sectors (for example financial services) already have a strong focus on resilience – but there are other regulatory drivers to be considered - for example, good GDPR and cyber accountability frameworks should incorporate organizational and technical security and resilience measures and, in relation to technology arrangements, may have implications regarding data residency/sovereignty.

With a variety of resourcing/procuring models available, weigh the pros and cons of plug-and-play/commoditized arrangements as opposed to long-term strategic partnerships. Part of this will be weighing up the benefits of being able to swiftly scale/port arrangements against the likely pricing premium (and potential disruption risk) in doing so and the possibility of vendor lock-in or vendor concentration risk.

It's not just a question of commercial need and regulation

Increasingly organizations are not only driven by what they have to do (to comply with regulation) but by a deeper sense of purpose and a commitment to 'living their values'. As we explore in our chapter on environment and societal law, your organization's values will also drive a new dynamic in procurement and contracting arrangements.

Existing vendors – key steps

Without a vendor assessment exercise of some sort, only a small number of organizations are likely to be confident that their risks are appropriately covered across all their supply contracts. Therefore, project legal teams should examine (possibly with the help of AI tools – as referenced in the Focus on Digital chapter) conducting an audit of all their existing vendor arrangements with a focus on the following:

Original commercial drivers remain true: Factors to be considered, for example, may include the extent to which the existing procurement structure (prime, multi, hybrid etc) continue to offer agility and drive supplier incentivization; whether any existing vendors are distressed or need enhanced monitoring; whether the locations for production/supply/hosting do not give rise to undue risk to business continuity in the event of future pandemics or other material interruption events etc.

Existing/new regulatory constraints: Assess the local or regional regulatory context affecting the arrangement – has this changed or attracted a higher cost or risk overhead in light of the COVID-19 experience? For example what are the physical controls? (tariffs/embargos/customs constraints) organizational challenges? (Lockdowns/commuting restrictions? Immigration challenges? New technical constraints? Export control requirements or data-related considerations (data residency considerations, employee monitoring etc.)?)

Baseline existing contractual terms: This process may have already occurred as part of the immediate COVID-19 response but an assessment should be undertaken of key contractual terms affecting resilience: for example force majeure, MAC, HR, change control, pricing and exit clauses

A suggested approach: A program should be put in place to document the above findings in a single tracker, along with other material information, such as:

- Commercial drivers enhanced commercial risks
- Constraints imposed by existing terms and/or regulatory context
- A difficulty rating with regard to the procuring of an alternative supplier
- Details of the contract value/business materiality
- Other material points that might impact your decision making.

With all the above data stored into a contract management tracker (which could simply be an Excel spreadsheet if you don't have other options available), you would then have a resource that can be easily manipulated to answer questions your organization and team might have at this time in terms of:

1. Volume of non-optimal supply contracts (from a risk mitigation perspective) currently in play.
2. Business "owner"
3. Risk posed to business in the event of pandemic/ material interruption event

4. Existing mitigants
5. Prioritization scoring for remediation

With new vendors

In addition to reviewing the existing supply chain, thought should be given to re-engineering your procurement processes to ensure they are optimized for delivering organizational resilience. For example:

Procurement strategy

If as a result of your resilience review, your organization decides it needs to diversify its supply chain model, then you have the opportunity to:

- **Risk transfer at the outset:** Amend your ITT/RFP documentation to require future suppliers to fully address identified risks and proactively configure their own resilience measures to meet your enterprise requirements – for example, setting out specific resilience requirements and specifications as part of the ITT/RFP pro-formas
- **Optimising vendor models:** Much will depend on the business's risk exposure (and tolerance) for future business interruption. For those businesses that have outsourced to third party locations, they may have experienced significant product movement, resource procurement and/or workflow availability issues. Therefore if the change in procurement strategy is driven by a near-shore imperative, consider optimal vendor model (prime, multi-source or hybrid?). For businesses seeking always-on tech-driven services that are quickly scaleable, they may be attracted to infrastructural/cloud or Software-as-a-Service offerings, but these can give risk to privacy considerations (international transfers, residency, incident risk etc) as well as potential vendor concentration risks.

Agility at a price?

Vendor and supplier markets are likely to evolve to offer certain resilience tools within their core offerings, where bespoke controls are required (for example sub-contracting control/collateral arrangements, vendor swap-out regimes, mandating specific production or hosting locations, accelerated rights of early termination etc). These may well only be achievable in the short-term at a price premium.

Template refresh

Review/upgrade your precedent clauses around force majeure, cost control, change management, sub-contracting, compliance with law etc. to ensure they reflect your lessons learned from this pandemic. For tech or data heavy procurements, further considerations are set out below.

New technologies: fresh contracting approaches

With COVID-19 accelerating the digital investments/ digital strategy implementation of some organizations (which may include a pivot towards AI/MLP technologies, automation and big data tools), in-house legal teams should consider what new legal issues are posed when procuring these platforms. Careful thought should be given to:

- new licensing scope and usage considerations (for example, when an AI or RPA tool interacts with another software application, does that count as use?)
- enhanced availability and performance requirements from SaaS partners, including mandatory swap-out regimes
- appropriate risk allocation with the vendor, not least around down-stream resilience, fitness for purpose and IP infringement / data risks
- accountability for innovation and continuous improvement commitments (lined to service resilience as well as business outputs)
- IPR exploitation – from open source issues to consideration of rights of exploitation of any newly developed or derivative IPRs etc

Often the data to be processed is as critical as the technology deployed. From a GDPR perspective for example, the following should be considered: cookies/online behavior; processing transparency/ lawful bases; impact assessments;

data residency/ international transfers; processor management; cyber and information security management, general accountability and compliance frameworks.

Business process optimization

Any operational resilience agenda, especially one which is reliant on technological transformation, will likely require accompanying organizational change. Indeed, most business efficiencies and transformations are not delivered by technology alone – and so in-house legal teams will need to support their business stakeholders to consider how the relevant solution(s) map into existing human and organizational processes and whether any such processes need repurposing alongside (or ahead of) the technology deployment.

Clearly there is much to consider, review and implement in terms of your organization's vendor management strategy. However, this is also a period of opportunity – an opportunity to review existing supply chains and optimize future procurements so that your business emerges stronger and with greater agility in the event of future disruption – by pandemics or otherwise. The legal team's role should not be underestimated by business leadership – this team is a core enabler for future enterprise resilience.

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