SQUIRE PATTON BOGGS

De-risking Your Supply Chain

UK – 2025

There are an almost infinite variety of issues that can arise within the supply chain. Minor irritants that historically may have just made business a bit more difficult to transact can, in the current environment, cumulatively exert significant pressure. Additionally, an over reliance on a third party or failure to spot the weakest links in this chain could have a catastrophic impact on your business.

Rising fuel and energy costs are continuing, meaning gas prices are at a 15 year high. Port congestion in the US over the past few years have also slowed supply of various materials, as well attacks across the Red Sea which have reduced transportation across one of the world's most critical waterways.

Fuel and energy prices were already under pressure as a result of the Russia/Ukraine conflict, as well as the associated sanctions on Russia impacting supplies of raw materials and products (such as wheat fertilisers and automotive parts), semi-conductors, key metals, minerals and gases.

To help businesses mitigate the potential impact on their own supply chains, we have produced this quick guide that highlights potential pinch points in a supply chain, and sets out options to defuse the risk in.

This note is intended as guidance only and should not be relied upon as legal advice. Should you require advice in relation to your own specific circumstances, please contact one of our team whose contact details are at the end of this guide.

How to Identify Pinch Points in Your Supply Chains

Every supply chain will be different, and your exposure can depend on where you sit in the chain. Undertaking a supply chain mapping process involves reviewing the whole of a business's supply chain (including your supplier's suppliers) to identify risk areas, assessing the likelihood and potential impact of identified risks, and developing contingency plans for worst-case scenarios. However, what are the key risk areas to look out for?

Supplier Showing Signs of Stress

If a key supplier fails or starts to underperform, this can pose a serious threat to a business, particularly if it does not have a plan to address the impact. The supplier may be experiencing short-term cash flow problems, supply problems of its own, or something more serious that could lead to an insolvency process.

Identifying stress in a business that is not your own, and where you do not have access to the financial details, can be difficult. However, there are a number of indicators/enquires that we have set out below to help you "stress test" your supplier (see "How to Stress Test Your Supplier").

It is important to monitor and audit a supplier's financial health throughout the life of the contract at regular intervals as well as key stages, such as inception and when contracts are renewed, particularly where a supplier is critical to a business.

Contract Review

Is your business tied into a fixed-cost supply contract that is no longer competitively priced? Are there contractual protections to address raw material/product price increases, pass on freight costs, etc.? Are you certain which terms and conditions are incorporated, and what they mean? Do you have a contractual right of audit?

Reviewing the terms of supply contracts will help identify whether the provisions are sufficiently robust to protect your business in the event of a supplier failure, to enable you to terminate a contract should you need to, or to renegotiate price or other terms.

Geopolitical Issues

Identify which suppliers are, or could be, impacted by sanctions or trade restrictions. What connections do your supplier and its suppliers have to Russia/Belarus/Ukraine? Examine the raw materials and components you receive from your suppliers to look through and identify any levels of the supply chain that may suffer from trade blacklists and plan how each element could be removed in short order if required.

Different companies will be affected by the imposition of/increases in tariffs, blacklisting and other trade restrictions in different ways, but actively monitoring trade policy developments and assessing the consequences of changes before they happen enables a business to amend contracts to pass risk or terminate, make alternative supply arrangements or shorten the chain.

Import/Export Challenges

There are a number of import/export challenges that can affect supply chain performance. Being aware of factors such as the following (and how they will impact your suppliers) will help you formulate a plan to address them:

- The imposition of tax and duties may increase prices
- Delays at borders and freight holdup may impact contract deadlines
- Changes in VAT registration and other tax requirements, including reporting and collection obligations, could also cause price fluctuations or delays in performance
- Changes in customs practices that may result in product/component delays, shortages and/or increased costs
- Changes to product certification and registration
- Risk of significant changes in inflation rates (and variations in these between countries) may hike prices

Consider the extent to which costs may be passed up and down the supply chain and how delays/shortages will impact the ability of your business to perform its own contracts.

Lack of Competition/Viable Alternative

Does your business have a sole supplier arrangement or is there a key supplier who you feel overly reliant on? Are you tied into any exclusivity arrangements? Have you considered whether there are any viable alternatives? Work out how important your suppliers are to you if something goes wrong with them, and plan accordingly.

Other Risks

While it is easy to focus on the above issues, maintaining an ongoing assessment of your supply chain for IT risks, compliance with data protection and anti-corruption laws, and potential ESG issues, as well as reviewing suppliers' product safety history, will help reduce the risk of potential hefty fines for non-compliance, significant reputational damage, expensive product recalls and interruptions to critical supplies.

How to Stress Test Your Supplier

Individually or taken together, the following factors may indicate that your supplier is a risk to your business:

Late/missed delivery dates – Be vigilant for any early warning signs, such as late or missed deliveries. Are you being "gazumped" by other customers while goods are in transit?

Disputes (e.g. quality/quantity issues) – Has the quality of products lowered? Are you returning more items? Are there shortfalls in delivery? Is the supplier trying to avoid dealing with matters or unnecessarily disputing your claims?

Change in behaviours/conduct – This could be anything, but noticeable changes in how a supplier engages with you could flag underlying issues, i.e. requests for money on account (where that is not usual practice) or aggressive credit control.

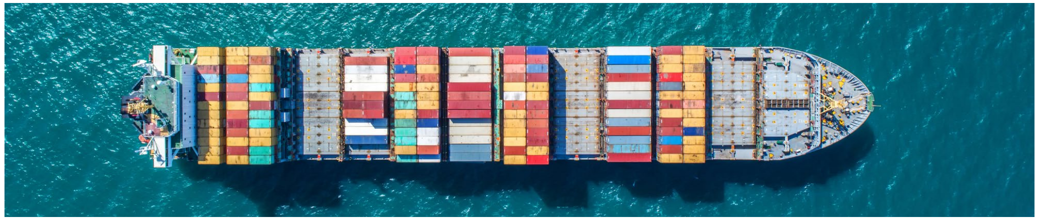
Economic conditions/Sector challenges/Political events – External factors impact the viability of all businesses. How do these affect your suppliers? Are they particularly reliant on a country that is now in turmoil, blacklisted or affected by sector issues, i.e. availability of raw materials? Will increased tariffs or inflationary rises "stress" your supplier?

Credit checks – These are often run at the start of a relationship, but by running regular credit checks, you can keep track of your supplier's credit rating and whether it is deteriorating. If this is not possible in house, there are many external providers who offer this service.

Financial Information – What do the records at Companies House say? Are accounts being filed late? Review the latest accounts: Is the financial position of the supplier worsening? Consider the wider group position: Is there an underperforming subsidiary or loss-making division that may impact the performance of your supplier? What is the inter-company debt position?

Insolvency – Check Companies House to see if an insolvency practitioner has been appointed and review insolvency notices published in The Gazette on a regular basis. Something as simple as checking who has signed in when visiting a supplier might highlight that they may be taking advice on their financial position!

News/Social media reports – Keep an eye on what is being reported. Sometimes insolvencies are first reported in the news, but reports may also reveal whether your supplier is involved in a contentious dispute or other financial difficulty, or is in acquisition talks. Further, if there is a lot of bad press about your supplier, this might indicate that all is not well.



De-risking/Managing Supply Chain Stress

If you have identified potential areas or suppliers of concern, there are a number of options available to proactively address the risk:

Alternative Sourcing (Dual/Local/Multi) and New Suppliers

Finding alternative suppliers and dual/multi sourcing products mitigates (potentially in different geographical locations) the risk of an unexpected issue with a key supplier. It is also important to identify and monitor particularly carefully any areas where dual sourcing is not possible and plan how you would deal with the loss of any single-source supplier.

Identify practical issues that could make it difficult to move to a new supplier (e.g. tooling held at the supplier's premises, certifications tied to a particular production line or reliance on proprietary supplier intellectual property) and put in place contractual protections or contingencies to deal with these.

Moving to local suppliers can also reduce the risk of logistics issues and delays where suppliers are based overseas.

Shorten the Chain

Identify how you can shorten the supply chain. Use different distribution channels, platforms, technologies, products, sources, etc. Consider acquiring a supplier, as integrating your key supplier into your business through a merger-and-acquisition (M&A) process will give you more control. If logistics (and the increased costs of transportation) are a challenge, can you leverage scale?

Litigation

Consider whether it is appropriate to bring a claim against a supplier for breach of contract or to terminate the contract and find an alternative supplier.

Finance Options

If cash flow is a problem for your supplier, introduce a funder or consider providing working capital funding directly (with appropriate protections).

Renegotiate Contract Terms

Renegotiate key contracts to ensure that they contain sufficient contractual protections:

- **Termination** – Ensure termination provisions in the contract are robust and can be enforced at the earliest opportunity and ensure that exit plans have all been agreed and tested well before any potential contract termination event occurs. Consider including rights to terminate and/or increased monitoring for material adverse change in the supplier's finances. Is there an ability to pause the contract?
- **Insolvency** – Ensure that the insolvency provisions in contracts are up to date, appropriate for the jurisdiction and take effect early enough in the insolvency process.
- **Retention of title** – Be aware of any retention of title provisions and assess their likely effectiveness.
- **Payment terms** – Can these be flexed to support a stressed supplier or improved to support your business?
- **Price increases** – Do the terms address how price/cost increases, the impact of currency fluctuations, and the associated risks will be mitigated and/or shared?
- **Address specific issues (e.g. lingering Brexit and/or COVID-19 challenges)** – Whether as general terms or to address specific identified issues (e.g. tariffs, delays, materials/staffing shortages, travel restrictions and costs).
- **Tariffs** – Who will bear the cost of any new duties/tariffs that may be imposed and any associated additional administrative and logistical costs? Delivery terms (e.g. EXW, c.f. or DDP) may, therefore, take on added importance.
- **Sanctions** – Assess risks to performance of the contract by the imposition of/increases in tariffs, blacklisting of companies and other trade restrictions and determine whether there is scope for passing these down the supply chain or terminating arrangements that are/become uneconomical or unlawful.
- **Financial health protections** – Ensure contracts are signed with the group company against whom financial due diligence has been performed and seek parent company guarantees where appropriate.
- **Audit Rights** – Include audit rights to obtain necessary information/documents from your supplier as well as obligations on the supplier to do the same with their suppliers and to report to you.
- **Bolster compliance and processes** – With an ever increasing focus on compliance, remember to address key focus areas and include protections on hot topics such as data protection, IT and cybersecurity, anti-bribery and corruption (ABC), product safety (and product recall) and environmental, social and governance (ESG).

Being proactive, rather than reactive, means that a business can put in place measures to de-risk any threat before it occurs or manage the risk with the least damage (financial or reputational) to its own business.

If you wish to explore any of the options highlighted in this quick guide or understand better how your business can de-risk its supply chain, please contact one of our lawyers, whose details are below.

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