SQUIRE PATTON BOGGS

Where Are My Chips?

Avoiding and Resolving Disputes in the Chip Industry

UK – October 2024

If you subscribe to the view that Artificial Intelligence (AI) is going to change life as we know it, then you will have a vested interest in the semiconductor industry. Semiconductors, or chips, are the workhorses behind AI and nearly every modern digital technology. Chips are so vital that they have been described as the "oil of the 21st century", turning companies like Nvidia and TSMC (leaders in advanced chip design and manufacturing respectively) into household names.

It is therefore surprising that the supply chains underpinning this crucial component remain some of the most precarious. Key risks include:

- Chip manufacturing remains a highly globalised activity, despite recent initiatives by governments to "onshore" more of the supply chain.
- Key stages of the production process are geographically concentrated. Localised disruption can therefore have global ramifications for supply, demand and pricing dynamics.
- Global supply and demand can be volatile. While some companies, like Nvidia, have benefited from strong demand, other parts of the industry have seen oversupply. The long-term growth potential of key demand drivers, such as AI, is still uncertain.
- Governments employing more muscular trade policies, for example through export controls and sanctions.

It is fair to say that chips increasingly resemble a commodity. As disputes lawyers, we deal in the legal mechanisms and frameworks which have developed to respond to disruptions in similar markets. The purpose of this article is to consider how, from an English law perspective, some of these concepts may apply to contractual arrangements in the chip sector. In so doing, we hope to show the practical value that advanced thinking about potential disruption can bring.

Most people will be familiar with the concept of *force majeure*. We have written about its potential applicability to chip contracts in the past.[1] *Force majeure* clauses generally operate to release contractual parties from their obligations upon the occurrence of certain disruptive events, for example extreme weather or war.

This is an obvious first port of call in any kind of market disruption, as anyone who recalls the abundance of legal insights published after the outbreak of COVID-19 will appreciate. But some basic features are worth recording. Under English law, much depends on the nature of the event and the wording of the *force majeure* provision itself. The event obviously needs to be captured by the clause. But even then, a party looking to rely on *force majeure* will still generally need to show a connection between the event and its own ability to perform, that the event was beyond their control and that performance could not be maintained by taking reasonable steps. Every contract is different. The wording and context of *force majeure* clauses will differ from contract to contract. As a result, one can only analyse the scope, meaning and effect of a particular provision by considering the express language used.

Earlier this year, the UK Supreme Court provided some interesting guidance on what reasonable steps involve in this context. In *RTI Ltd v MUR Shipping BV*,[2] a party to a charter agreement was contractually required to make payment in US dollars, but found itself hampered from doing so due to the introduction of international sanctions. It offered to pay in euros instead. The receiving party declined and declared *force majeure*. The Supreme Court found in the receiving party's favour. Having declared *force majeure*, the party did have to take reasonable steps to continue performance. But what was reasonable had to be determined by reference to the party's ability to perform what was written in the contract. A refusal to accept some other mode of performance did not preclude a declaration of *force majeure*, even if the overall result might be said to be the same.

1 *Avoid Contract Disputes from Export Controls in Chip Industry*, Bloomberg Law, December 2022 (https://news.bloomberglaw.com/us-law-week/avoid-contract-disputes-from-export-controls-in-chip-industry).

2 *RTI Ltd v MUR Shipping BV* [2024] UKSC 18.

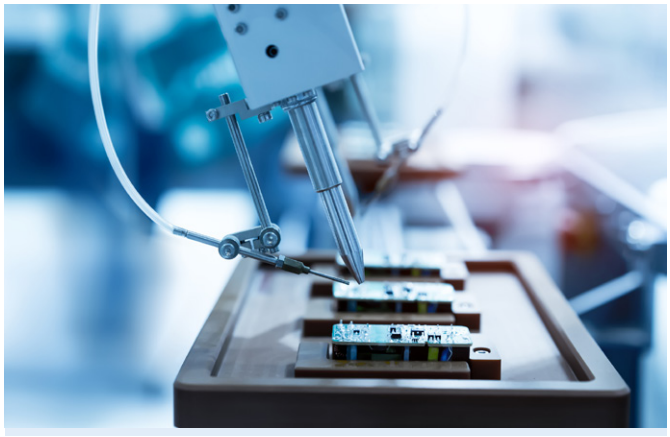
This kind of insight may be useful when navigating the back-and-forth that can immediately follow a disruptive event. It is not difficult to imagine scenarios like this in the context of the purchase and sale of chips, or some of the specialised components or machinery used in developing them. The destruction recently caused by Hurricane Helene, for example, included the flooding of a mine in North Carolina where an estimated 90 percent of a specific type of quartz used in semiconductor production is produced.

A separate concept that can apply in instances of external disruption is the common law doctrine of frustration. Again, this is something we have touched on in previous market insights.[3] Under English law, where something happens after a contract is entered into that makes it impossible to perform, or radically changes the nature of the bargain, frustration may allow the contract to be ended. This might include a radical change in the legal environment affecting what a party would otherwise be required to do under the contract,[4] for example the introduction of export controls or sanctions. It should be noted, however, that claims of frustration are challenging and seldom succeed.

Relatedly, where a contract requires something to be done in a foreign jurisdiction that is unlawful in that jurisdiction, then under English law performance of that obligation may in certain circumstances be excused.[5]

Like *force majeure*, these are concepts we may see becoming increasingly prevalent in chip transactions. Again, however, caution is needed.

Whether an English law contract is frustrated, for example, involves a "multi-factorial" analysis, considering things like the terms of the parties' contract (whether they pre-empted the intervening event in any way), their prior knowledge or expectation of risk and the nature of the disruptive event.[6] Parties claiming that performance of an act is illegal in a foreign country will need to give careful thought to whether that is really the case, or even whether they have identified the right place of performance. In a sanctions context, if it is possible to obtain a licence or exemption to do something—as many sanctions regimes proscribe—then an affected party will likely have to show it has taken reasonable steps to obtain such an exemption before these principles will aid them.[7] As these examples show, there is invariably more to the application of these concepts than meets the eye, once applied to the real world. It is why it can be so difficult to successfully rely on them.



The observations above will be confined to contracts governed by English law. But there are perhaps more general lessons here. Linking back to the chip sector, they underscore the value of a "look before you leap" strategy when confronted with a disruptive event. There may be legal mechanisms that can assist where contracts are affected by changes in trade policy, for example. But the underlying legislation will need careful analysis, alongside factors such as the availability of alternative modes of performance and the extent to which the disrupting event is catered for in the wording of a contract. These are multi-layered issues that will vary from case-to-case, legal system-to-legal system and will often not have a clear-cut answer.

In an increasingly volatile world, supply chain resilience has risen to the top of many companies' agendas. This is more important in the chip industry than perhaps any other. But resilience also involves an appreciation of legal risk, and it is therefore likely we find concepts such as those touched on in this article talked about more and more in the coming years.

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3 *2023 Legal Trends in Chip Industry Markets*, Supply & Demand Chain Executive, April 2023 (https://www.sdcexec.com/sourcing-procurement/manufacturing/article/22820250/squire-patton-boggs-2023-legal-trends-in-chip-industry-markets).

4 *Canary Wharf (BP4) T1 Limited v European Medicines Agency* [2019] EWHC 335 (Ch) [41].

5 *Libyan Arab Foreign Bank v Bankers Trust Co.* [1989] 1 QB 728, 743F.

6 *Edwinton Commercial Corp and another v Tsavliris Russ (Worldwide Salvage and Towage) Ltd (The "Sea Angel")* [2007] EWCA Civ 547 [111].

7 *Celestial Aviation Services Limited v UniCredit Bank GmbH* [2024] EWCA Civ 628 [106].