

# CLIENT ALERTS

---

## Impact of Coronavirus Spreads to the Auto Industry

2.3.2020

The World Health Organization declared the spread of a new strain of coronavirus that is centered in China a “global health emergency” last week, sending global markets into a steep downward spiral, causing major global airlines to suspend flights to China, and resulting in the issuance of a “level 4” emergency warning by the US State Department admonishing citizens to avoid traveling there. Many international companies have imposed travel bans and/or removed employees from China, and some countries (including the U.S.) have begun imposing travel restrictions on Chinese visitors, as well as screening and in some cases quarantining all travelers returning from China.

Most of the over 17,000 cases (and over 350 deaths) that have been confirmed so far are in China, although cases have been reported in 22 other countries as well. The epidemic reportedly began in an animal and seafood market in Wuhan, a city with a population of 11 million located in the central China province of Hubei, at the beginning of the celebration of the Lunar New Year. Although screening tests do exist, there is no vaccine, and researchers, hampered by incomplete data, cannot yet answer many questions about how infectious or lethal the virus is, or how it is spread.

All public transportation in and out of Wuhan has been shut down at least until February 4<sup>th</sup>, as have factories, businesses, and schools. These closures are likely to be extended for weeks or more. Wuhan, known as the “Motor City” of China, is the headquarters of major automotive and steel producers.

The disruptions to the global automotive supply chain caused by these events may well continue for some time and become increasingly severe, as approximately 1000 new cases a day continue to be reported. Even suppliers that are not directly or immediately affected may experience some disruptions to their supply chains as the difficulties encountered by many tier 2 and

### Related People

Catherine M. Karol  
Of Counsel

### Related Services

Health Care

Health Care Industry Team

International Business

International Trade and  
Customs Specialty Team

## CLIENT ALERTS

---

tier 3 suppliers continue to ripple upward. As OEM plants reduce their production schedules to contend with parts shortages, purchasing forecasts could be sharply reduced and, in some instances, even suspended, causing ripples back downstream. Buyers and sellers, with and without a physical presence in China may nonetheless feel the pain.

Prudent buyers and suppliers will review their contractual rights and obligations at the earliest opportunity before situations become critical. Nearly all automotive supply contracts include “Excusable Event” or “Force Majeure” provisions that address unanticipated events that are beyond the reasonable control of the affected party, and that are not attributable to that party’s fault or negligence. Even when the written contract is silent, background principles of contract law also address such events. (For U.S. contracts, the most important of the contract law principles are Sections 2-615 and 2-616 of the Uniform Commercial Code (“UCC”). For foreign contracts, the Convention on the International Sale of Goods (Article 79) may apply.)

These contractual and legal principles may excuse delay or performance due to the unforeseeable event; however, what relief may actually be provided to an affected party can vary widely. It became very clear after the 2011 earthquake and tsunami in Japan (and other subsequent natural disasters as well) that these provisions are not models of clarity, in no small part due to the unforeseeability.

The general rule is also subject to significant limitations and obligations:

**First**, the party looking to exercise these rights must provide prompt, written notice of actual or potential delivery (or other) difficulties. Contractual force majeure provisions may include particular notice procedures or other requirements. Proper notice must include identifying whether there will be a delivery delay or failure. The notice should also be updated as circumstances warrant.

If you are the recipient of such notices from any of your suppliers, you should immediately analyze your inventory and forecasting to determine whether you need to provide corresponding notices to your customers as quickly as possible. Prompt notice allows parties to act quickly, to examine alternatives, and to mitigate losses. Failure to provide timely notices and updates could compromise the protections that might otherwise be available to you.

**Second**, You should immediately review your agreements for any applicable Excusable Event or Force Majeure terms, because the particular terms of your agreement may expand or limit your rights differently. For example, some terms establish specific time limits and processes for giving notice, and some contracts allow buyers to pass on cover costs to the supplier invoking the provision.

**Third**, your performance or delay may be excused only if there are no reasonable alternatives for performance. For example, there may be disputes as to whether the disaster is preventing performance or simply making it more difficult to perform. Whether you could have found a way to resume supply may be disputed by your counterparty.

## CLIENT ALERTS

---

General rules of contract law and many contract provisions require you to make reasonable efforts to restore supply. Performance might be possible at dramatically increased costs, or by arranging for an alternate source of supply. In general, higher costs do not excuse performance, but truly extraordinary costs may. Similarly, some suppliers may be able to supply some, but not all, of their customers' requirements. In such cases, suppliers generally must allocate supply among their customers in a "fair and reasonable manner."

**Finally**, even if performance is excused, that does not mean that there might not be adverse consequences for you. For example, under some circumstances, the customer may be able to terminate the agreement or pass on some or all of the extra costs it incurs. The legal rules in this area are complex and very fact-specific. If a customer attempts to take such action, you should consult counsel.

Impacted suppliers should review and identify insurance policies (particularly business interruption policies) that could potentially afford coverage for resulting commercial losses. A comprehensive insurance policy may include a "Business Interruption" ("BI") provision, which can operate to reimburse the insured for profits it would have earned if the covered event had not occurred. Companies buy business interruption policies with their property insurance to cover loss of revenue if they are forced to close temporarily, but those policies are also likely to exclude communicable diseases, an underwriter in London and insurance executives said. Prompt notice is required under any insurance policy. Notice should be provided even if coverage is uncertain, or even unlikely. Consult with an experienced agent for additional advice regarding coverage questions.

For additional information on Force Majeure/Excusable Event clauses in automotive supply agreements, see [here](#).

**Catherine Karol**

313.225.5308

[karol@butzel.com](mailto:karol@butzel.com)

**Sheldon Klein**

248.258.1414

[klein@butzel.com](mailto:klein@butzel.com)

**Cynthia J. Haffey**

313.983.7434

[haffey@butzel.com](mailto:haffey@butzel.com)

**Daniel Rustmann**

313.225.7067

[rustmann@butzel.com](mailto:rustmann@butzel.com)