

The Impact of the Coronavirus on the Global Supply Chain

Alert

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At the end of December, China acknowledged the existence of the coronavirus, and this burgeoning health crisis is becoming a supply chain problem. China, a major manufacturing hub for materials, products and components being used around the world, has been significantly impacted.

Facing the fast spread of the virus, China took a number of steps--delaying the return to work of millions following the Lunar New Year celebration, blockading entire cities where the virus is found to be most prevalent, and transporting those with the virus to isolation camps.

In addition, travel, transportation and shipping services to and from China have been cancelled or restricted. Certain airlines have stopped flying to locations in China. Countries are instituting screening and isolation protocols to prevent those persons with symptoms from entering their countries and further spreading the virus.

Workers have been unable to get to factories to produce materials, products and components. Supplies have been delayed or prevented from transport to their destinations. This has impacted sales, the manufacturing of additional products, and the delivery of services elsewhere. Given the expanding reach of the virus, further impacts to the global supply chain are likely.

What Should Businesses Be Doing Now?

Because of the global nature of the supply chain, these problems are likely to impact businesses in the United States, delaying delivery of both raw and finished materials sourced from China and potentially other origins. This is likely to disrupt manufacturing, construction and other businesses that depend on such materials. For some, the disruption could interfere with the ability to comply with contractual

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commitments. For others, inventory shortages could lead to a reduction in sales revenues, which in turn, could have a material impact on performance and trigger reporting obligations. This week Apple reported that the virus would negatively affect iPhone production—and revised its forecasts.

These supply chain problems are not just the province of large multinational businesses. On February 9, Bridgewater, NJ-based Valeritas Holdings, a medical technology company specializing in the manufacture of insulin patches sought bankruptcy protection. The company blamed supply chain problems exacerbated by the coronavirus epidemic as the triggering cause of its bankruptcy filing.

In these situations, there are several proactive steps that businesses should be taking now to avoid or mitigate problems in the long run.

Identify Alternative Sources: Businesses should identify vulnerabilities in their supply chain and alternative sources to which they can turn. In identifying vulnerabilities, look beyond Chinese-sourced goods. As the virus spreads to other countries, so too could the supply chain disruption.

Review Contracts: Businesses that have contractual commitments that depend on foreign-sourced goods (or goods that include foreign-sourced components) should review those contracts to identify any rights and requirements under those contracts.

- Are there schedule and performance requirements?
- Does the contract address under what circumstances delay or non-performance may be excusable?
- Are there notice requirements if items are delayed or unavailable?
- Is there a force majeure provision and does it apply to your situation?
- Are you required to deliver in accordance with an established bill of materials or to use only qualified products, or can you substitute products or components if items are delayed or unavailable?
- Do you have any rated orders under the Defense Production Act? If so, you have an obligation to deliver what is required under the set schedule. You also may have a duty to notify the government or your higher tier contractor if there are performance and schedule risks.
- Are the increased costs of performance recoverable?
- Is your schedule impacted and can you obtain relief?

Communicate: Early and open communication with counterparties can help parties avoid or reduce problems as well as reduce the risk of litigation. This communication extends to businesses with lines of credit determined by a borrowing base formula. Generally, that formula considers a company's current accounts receivables or finished inventory as the collateral for ongoing loan advances. Advising your lender of the supply chain disruption in advance may avoid an unfortunate conversation later in the quarter. Similarly, lenders should check on borrowers and anticipate potential defaults resulting from these supply

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chain issues.

Document, Document, Document: If you do have to declare force majeure or otherwise excuse performance, you may need to be able to show not just disruption to the supply chain, but that the disruption prevented or delayed performance under the contract. This may require a showing of the efforts that you took to obtain product from other sources. It is critical not just to engage in such efforts, but to document those efforts contemporaneously.

Reporting Obligations: Prior forecasts and projections may be looking a little overly optimistic at this point. You may consider whether restating forecasts is warranted. Similarly, you should consider additional disclosures in annual reports or in reports to lenders. Disclosure and disclaimers may also be added in connection with representations in new financing or transaction documents entered into during this period.

These issues may also be applicable to your own supply chain members and further impact your performance. Businesses should be urging all of their vendors and subcontractors to take the actions recommended above. Consider developing a plan to identify and address these concerns. Being proactive and strategic now may help you to avoid problems down the road.

If you want to know more about how you might address these and other supply chain risks, please contact [Susan Warshaw Ebner](#), [Jill Radloff](#), [Darrell Clark](#), [David Rifkind](#) or the Stinson LLP contact with whom you regularly work.

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