



Defending your supply chain against coronavirus COVID-19 (United States)

Industrials Alert

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The coronavirus/COVID-19 outbreak has disrupted – and will continue to disrupt – supply chains worldwide. While companies will experience different impacts, stakeholders can take proactive measures not only to minimize the impact but also to provide opportunities. Here is an action plan that companies can implement to make strategic decisions related to potential supply chain disruptions.

1. Review potentially impacted contracts.

Review key supplier and customer contracts that may be affected by COVID-19. In particular, counsel should review these contracts to determine each party's rights and obligations, including the following:

Identify specific impacted terms, such as representations and warranties, covenants, most favored/preferred customer provisions, exclusivity, payment rights, liquidated damages, minimum production amounts, schedule and delivery, allocation rights, force majeure clauses, termination rights, and insurance or indemnity

- Identify any terms requiring notice, and whether they have been triggered
- Assess if either party's performance may be excused, or if a party can take measures to ensure performance; and

- Assess the risk and consequences arising from a potential breach or default.

2. Consider which jurisdiction's law governs impacted contracts.

The law governing the contract and the parties' relationship can materially affect how a company addresses any issues; therefore, before taking action a company should do the following:

- Identify any choice of law or venue provisions, as well as the scope of those provisions
- Absent governing choice of law or venue provisions, identify which jurisdiction's common law most likely applies to any dispute arising from the agreement and
- Assess how the relevant jurisdiction's law will impact the agreement's key terms or imply terms under common law, including frustration of purpose, hardship, impracticability, impossibility, material adverse change, duty of good faith and fair dealing, and force majeure.

3. Determine whether additional statutes or regulations could apply.

Because many contracts for the sale of goods also must comply with various statutes and regulations, companies should also do the following:

- Assess if the Uniform Commercial Code (UCC) or any state's adaptation of the UCC applies
- Assess if the contract involves an international sale such that International Commerce (INCO) terminology applies and
- Identify any regulations requiring action in the event of an outbreak, such as health and safety measures or securities disclosures (for example, due to earnings changes).

4. Become familiar with insurance policies or other indemnification sources.

Insurance or other indemnification agreements may cover some losses, and should be considered as follows:

- Identify any potential insurance coverage, including for business interruption or property impairment (note that after the 2003 SARS outbreak, many insurers excluded outbreaks from their coverage of business interruption claims absent physical damage)
- Determine whether any other sources for indemnification may exist and
- Provide notice to any insurance carriers or indemnitors in accordance with any applicable policies or agreement.

5. Review and implement troubled vendor programs.

Distressed vendors may face daunting operational and financial challenges that threaten their continuing viability. Many manufacturers have developed troubled vendor programs to provide the liquidity to support critical, sole source products integral to "just in time" manufacturing processes until alternative vendors can be located. To enhance repayment, manufacturers should explore measures with distressed vendors which could include the following:

- Require the distressed vendor to pledge or assign tooling and intellectual property required to supply the product;
- Obtain first priority security interests in collateral
- Explore debtor in possession financing, and associated protections, if a vendor must seek bankruptcy protection
- Waive contractual defenses or resolution of disputed accounts payable in exchange for advances; and
- Secure additional guarantees.

By taking these five steps, companies can implement an action plan that mitigates risk, allows flexibility in a developing situation, and provides a framework for making strategic decisions.

Learn more by contacting any of the authors.

See our reports on developing business legal issues arising from the coronavirus COVID-19 outbreak.

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