

Manufacturers, Distributors and Retailers – COVID-19 Forces You To Consider Your Contractual Remedies

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COVID-19 has caused serious disruption to manufacturers' ability to produce products and fill orders on a timely basis, which in turn has impeded the performance of countless supply chains. Factories and manufacturing facilities have closed or reduced capacity, airlines have suspended or reduced flights to and from China and other countries, ports have closed, containers have shipped less than full, and ocean vessels and other modes of transportation sit on "delayed status." All of this seriously impacts the cross-border distribution of products, including chemicals, commodities, electronics, construction materials, computer hardware, phones, toys, food products and textiles.

As a result, the purchasers of products made, distributed and delivered by those manufacturers, distributors and transportation firms are likely to be unable to satisfy or to be significantly delayed in fulfilling their contractual obligations to their customers.

For all companies with outstanding supply chain obligations, it is incumbent to review and evaluate several potential avenues to protect the business. The most obvious is force majeure. The World Health Organization (WHO) has declared the coronavirus a global health emergency. On Thursday, January 30, 2020, the China Council for the Promotion of International Trade released a statement that China was offering force majeure certificates to local companies who are unable to fulfill their international contractual obligations due to the coronavirus outbreak. To apply for the certificate, companies must provide legitimate documents demonstrating proof of delays or cancellation of transportation to the agency. Clearly, the recognition

by the WHO of the seriousness of the outbreak and separately, by the Chinese authorities, who are supporting that this outbreak constitutes a force majeure event, will be supportive evidence of a force majeure event even if not legally binding. Other countries' trade councils and commercial chambers also provide such certificates.

Accordingly, companies with outstanding supply chain obligations should consider whether the failed manufacturing capabilities or failed order fulfillment by the supply chain partners fall within the parameters of any force majeure clause in their supply contracts. If so, that clause may delay or change the timing of performance or absolve the parties from liability for failures of the contracting parties. This can be as important for the seller of the product that has been disrupted, as it is for the purchaser who, now delayed, may want to reject delivery on the order.

Force Majeure means "superior strength or force." A force majeure provision is a common contractual provision intended to relieve or excuse the contracting parties of liability due to extraordinary circumstances that are unpreventable because they are not within their control. Such events are generally set forth in the contract and often include things like wars, riots, epidemics, governmental action, natural catastrophes, and acts of God. Broader and more specific clauses include things like cyber-security incidents, acts of terrorism, and even labor strikes.

In practice, generally force majeure provisions are intended to temporarily relieve the parties of liability until stabilization of the events at issue permits performance to continue. Some force majeure clauses provide for suspension of obligations during the period of the applicable event. Others give rise to a right to terminate and some may relieve the non-performing party of liability for non-performance

of its obligations under the contract. However, the impact and effect of a force majeure clause will vary from contract to contract mainly because of the wording of the provision and applicable state or country law.

The courts also differ on the circumstances under which an event qualifies as a force majeure, whether events have to be specifically described in the provisions to be relied upon, and on the circumstances in which foreseeability of the event must be proven. Further, some countries imply that every contract has a force majeure provision. An inability to pay a financial obligation alone is normally carved out as not constituting an event of force majeure.

Bottom line—it will be up to the claiming party to prove an event like the coronavirus constitutes an event of force majeure under the applicable clause. With deference to the wording of the contract provision and the interpretation of the court in which the claim will be brought, it seems reasonable to consider arguing that it is a force majeure event if damages have been sustained as a result.

The shortage of component parts and materials for manufacturing purposes caused by the coronavirus will likely have an impact on pricing now and in future months, with the scarcity/demand for the finished product or such parts and materials driving price upwards. On the other hand, manufacturers and traders may expeditiously sell off products and commodities that are time-sensitive and perishable, losing considerable margin in the process. This happens routinely in the spot market for commodities when the contract price cannot be obtained.

In the supply chain context, if a purchaser is unable to get products delivered or orders fulfilled on time causing the purchaser to fail to

deliver those products to its customers or forcing the purchaser to reject the order and seek alternative supply/cover for the order elsewhere, that is a harm occurring in fact and not just a future threat.

Regardless of what position a company occupies in the manufacture and supply transaction, every company should evaluate whether its force majeure provision will provide any relief from failures of the supply chain. Other potential considerations for companies include alternative supply rights, and insurance requirements in the supply contracts, as well as their own insurance and other potential contract law defenses, like impossibility of performance and frustration of purpose. Finally, for all contracts covered by the Uniform Commercial Code (UCC), §2-614 Substituted Performance requires a commercially reasonable substitute performance to be provided in the event of circumstances that are commercially impracticable. §2-615 Excuse by Failure of Presupposed Conditions excuses a seller's delay in delivery or failure to deliver if performance has been made impracticable by the occurrence of a contingency, the non-occurrence of which was a basic assumption of the contract.

The [Polsinelli Global Franchise and Supply Network Group](#) is available to review and assist with evaluation of existing supply chain contracts, invoking force majeure or other defenses, and negotiating supply chain contracts.

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