

### The Coronavirus Threatens U.S. Company Supply Chains – Practical Tips and Contract Considerations to Manage Risk

#### Key Notes:

- The risk of coronavirus transmission from imported goods is currently considered highly unlikely
- U.S. businesses should engage in contingency planning, including evaluating alternative sourcing and the potential future need for increased transportation capacity
- Disruptions may affect contracts between U.S. businesses and Chinese suppliers, and U.S. businesses and buyers of finished goods
- Transportation contracts should be reviewed for minimum volume commitments and capacity protections

There are growing concerns that the Coronavirus (“COVID-19”) outbreak will have a serious negative impact on the global economy. U.S. businesses that depend on Chinese suppliers may soon be facing product shortages and supply chain disruptions. This bulletin (i) addresses whether U.S. businesses need to be concerned about the possible exposure to the virus from goods imported from China, and (ii) identifies contractual considerations to help companies manage potential supply chain risks based on their relationships with Chinese suppliers, customers and transportation providers.

#### Implications of the COVID-19 Outbreak

On January 30, 2020, the World Health Organization [declared](#) a global emergency, and in late January, the Chinese government extended the Lunar Year Holiday to February 10, 2020 amid its efforts to contain the

coronavirus outbreak. Although factories in China have slowly started to reopen, it is still being [reported](#) that many firms are facing difficulties obtaining government clearances and complying with new operating requirements, such as furnishing masks for employees. Chinese factories that have reopened are operating below capacity and production is limited. Transportation restrictions in China combined with reduced staffing are reducing air and ocean capacity with expected ripple effects in inventory shortages soon to be realized.

Unlike the Chinese New Year, the coronavirus was not part of corporate planning which increases the risk of supply chain disruptions on various levels for the many U.S. companies that rely on China-based suppliers. Not only is the concern of inventory shortages growing, but the potential for demand on transportation capacity to “peak” once operations return to normal is rising. Whether ocean and air carriers will be able to handle such a surge following capacity reductions during the outbreak is unknown, as is the possibility of delayed deliveries should there be port congestion. Together, these circumstances and uncertainties are causing anxiety for businesses with the concomitant need for companies to engage in contingency planning sooner rather than later.

#### Can the Coronavirus Be Transmitted to Persons from Imported Goods?

Based on current information available from the Centers for Disease Control and Prevention (“CDC”), it appears that

transmission of the coronavirus from imported goods is highly unlikely. The CDC [explains](#) that, although there are still a lot of unknowns about COVID-19, “because of poor survivability of these coronaviruses on surfaces, there is likely very low risk of spread from products or packaging that are shipped over a period of days or weeks at ambient temperatures.” The CDC also reports that, “Currently there is no evidence to support transmission of COVID-19 associated with imported goods and there have not been any cases of COVID-19 in the United States associated with imported goods.”

Thus, legal liability of U.S. businesses for transmission of COVID-19 from imported goods is a remote possibility. In line with this understanding, currently there are no restrictions on the cargo shipments from China. A February 3rd [bulletin](#) of U.S. Customs and Border Protection (“CBP”) explained that “[c]rew, and flights carrying only cargo (i.e., no passengers or non-crew), are excluded” from U.S. Department of Homeland Security’s arrival restrictions imposed on February 2, 2020. It has also been reported that “CBP continues to process cargo at its normal rate as there has been no identified threat as it relates to cargo shipments,” and that “vessels or embarked crewmembers or passengers that have recently been in China will have their arrivals fully vetted to safeguard the American public yet facilitate trade. This safety protocol is not anticipated to slow down the movement of cargo.”

Based on the remote risk of transmitting the virus through imported goods, the good news is that, at this time, CBP does not require companies to quarantine shipments received from China or otherwise change their handling of such goods which could increase costs and delays. However, due to the many unknowns with this form of virus, companies are advised to monitor the situation and obtain the latest available updates in case circumstances change.

### **Contract Considerations to Manage Supply Chain Disruptions**

As noted, in order to reduce commercial and legal risks created by the impacts of the coronavirus on Chinese sourced goods, companies should engage in contingency

planning to protect their own production schedules, to try and keep store shelves filled and to meet customer requirements. Evaluating alternative sources for goods that cannot be timely produced in China, as well as securing future transportation capacity are options to consider.

The remainder of this bulletin focuses on contract considerations to help companies manage risks of supply chain disruptions. These disruptions may affect both contracts between U.S. businesses and their Chinese suppliers and contracts between U.S. businesses and their customers due to the risks of nonperformance. Additionally, contracts with transport providers, such as steamship lines, air carriers, and 3PLs may be affected to the extent they include minimum volume commitments, delivery requirements and force majeure clauses or lack adequate protections as to future capacity needs and port congestion risks. In all cases, U.S. businesses are advised to review their contracts to understand performance risks and potential remedies for damages, as well as whether any amendments to address current and future impacts are needed.

Many contracts contain a “force-majeure” clause which deals with situations that are out of the parties’ control and that make the performance of the contract impossible, illegal or commercially impracticable. These clauses aim to relieve parties from legal liability for non-performance upon the occurrence of these types of events, such as natural disasters, Acts of God, war, terrorist attacks, or labor strikes. Whether the coronavirus qualifies as a force majeure event that would excuse the non-performance of a Chinese manufacturer to supply goods or, likewise, the non-performance of a U.S. company to deliver finished goods containing Chinese produced parts to a customer requires a review of the specific force majeure clause. Once the force majeure clause is invoked, it typically suspends the performance of the obligation until the resolution of the force majeure event or if the force majeure event continues for an extended time period, termination of the contract may be possible. In many cases, force majeure clauses require the affected party to give timely notice to the other party as to the occurrence of the force majeure event.

In the absence of a force majeure clause that addresses these issues, parties may be able to rely on contract defenses arising under state law, such as impracticability of performance or frustration of purpose, which would generally absolve parties from performance obligations upon the occurrence of an unforeseen event that makes the performance impracticable or frustrates a party's principal purpose of entering into the contract. (See Restat 2d of Contracts, § 261 et. seq.)

An impacted U.S. importer may be able to mitigate risk to the extent its supplier contracts allow for re-negotiation of pricing based on unforeseen circumstances or if its customer contracts provide for some cost-recovery in the event re-sourcing of goods is required for non-performance. Companies should understand whether the coronavirus impacts may trigger default rights and remedies under supplier and customer contracts, including an ability to cure any breach.

Contracts with transportation providers should be carefully reviewed to determine if a reduction in shipments from China creates exposure under a minimum volume commitment, or if capacity protections exist should there be a surge in demand once Chinese goods production returns to normal levels. Additionally, an unplanned future strain on vessel capacity could lead to delays caused by port congestion and the risk of increased demurrage expense. Companies should consider planning for these potential contingencies now, including contracting with new suppliers if necessary and/or amending their existing contracts, if they currently fail to include necessary protections.

To reduce adverse impacts to supply chains, it is essential for U.S. businesses to stay ahead of the curve and address these issues timely. Going forward, businesses should carefully draft clauses that address these types of epidemics. Clearly, there is no one-size-fits-all solution to cure the effects of supply chain disruptions caused by COVID-19. Options available to businesses will depend highly on the language of the contracts, specific facts and circumstances and the law applicable to the commercial arrangement.

## FOR MORE INFORMATION

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