

In a prior client advisory on the legal implications of coronavirus disease 2019 (“COVID-19”) in China, we explored employment, force majeure, data privacy, tax and other issues. This client advisory supplements that by identifying some specific supply chain issues that we are seeing. China is the manufacturing hub of the world, and supply chain issues there are generating global consequences.

Product Quality – Due to the nationwide shutdown of factories and businesses, many companies now confront a shortage of raw materials and components. There is also growing concern among some manufacturers that suppliers that are struggling to meet demand in this challenging market may substitute materials that have not been quality-tested or are not in-spec. A second issue we are seeing is demands from customers for assurances that products and raw materials/components have not been contaminated by the virus. We are also seeing customers asking their suppliers for contingency plans with respect to that supplier’s own supply chain to ensure that there is a backup if its sources of raw materials are disrupted.

Shipping – Many shipping and logistics companies in China stopped operations for a time, and road, rail and sea deliveries have all been affected. Some companies have resorted to shipping by air in order to maintain their customer relations and to avoid a breach for late delivery, but we have seen air and some other freight rates increase considerably over pre-virus levels. Moreover, many airlines have stopped some of their flights to/from China.

Insurance – Companies should review any applicable insurance policies to determine if there is coverage for economic losses arising during this virus period. Many insurance policies exclude losses arising from force majeure, but others may be more inclusive.

Financial Stress and Bankruptcy – Traditionally, small and medium-size suppliers in China operate on very low margins. Many of them are struggling from the prolonged shutdown and related adverse effects of COVID-19. Upstream customers should review their supply chains for such risks and seek to identify alternative sources of supply. In some situations, we are seeing that customers are providing limited financial assistance to selected suppliers to keep them afloat and functioning during this period if banks are not willing to finance them.

Force Majeure – Some companies have received from suppliers so-called “force majeure certificates” from the China Council for the Promotion of International Trade (“CCPIT”). Companies should realize these certifications only indicate that the stated conditions have occurred; they do not constitute a binding determination on the legal issue of whether a force majeure has occurred. Please refer to our prior client advisory for an analysis of the force majeure issues from a legal perspective.

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