

In March, as part of our efforts to assist our clients to navigate the uncertainties brought on by the global spread of the coronavirus disease 2019 (COVID-19) and measures that are being implemented to combat the pandemic, we invited our clients and contacts to self-assess their contingency arrangements using our [complimentary online contingency planning tool](#).

Responses have been received from a broad spectrum of sectors (including aerospace, automotive, food and drink, retail, industrial and consumer products) and replies received to date have revealed some interesting findings.

It would appear that a majority of respondents across all sectors have assessed the potential impact of COVID-19 on cash flow, as well as on their customers or end users, and have taken measures to adapt their distribution networks accordingly. It would also seem that, mindful of the risks of disruption to supply networks due to travel, export or import restrictions imposed on goods and people, a majority of respondents are endeavouring to maintain good lines of communication with their key suppliers, logistics providers and end customers as to what they are doing and the steps they are taking on a regular basis.

However, seemingly, a number of areas (at the current time of completion of the online contingency planning tool at least) have not been receiving as much attention, including:

- Alternative sourcing
- Supply chain visibility
- Regulatory compliance
- *Force majeure* and material adverse change (MAC) provisions in contracts
- Financial support

In this alert, we set out some of the key considerations for each of these areas. We anticipate that legal advice may be important for many of them, particularly in terms of (1) agreements, negotiations and potential disputes with suppliers (and customers); (2) funding and structuring arrangements; and (3) compliance with applicable legal regimes.

## Alternative Sourcing

While a majority of respondents have yet to consider this area, **as global supply networks come under increasing strain, pressure will increase on certain producers to source alternative materials, components and ingredients in the production of industrial and consumer products in order to get around shortages and to meet demand.** There are indications that this is already happening, with clients in our food and drink and essential packaging networks, for instance, reporting a surge in demand for their products, which is necessitating a rapid turnaround in the entry into contracts with new suppliers, albeit for typically shorter terms than usual given that the upsurge in demand caused by the COVID-19 pandemic is not expected to be for the long term.

Conversely, for other businesses, there has been significant supply chain disruption, as well as overnight evaporation of demand and loss of business as a result of many customers closing down operations due to the implementation of measures designed to combat the spread of COVID-19 (e.g. in-country lockdowns and the closure of non-essential business operations). For instance, a High Street fashion retailer recently announced that, as a matter of survival, it was suspending payments to suppliers for existing stock indefinitely, that such stock could be collected by its owners and that it would not only cancel orders for its spring and summer clothing lines, but it also would not pay costs towards those orders.

Issues such as those highlighted above can also translate into legal and insurance risks, with the result that:

1. Contracts should be reviewed to check provisions concerning delivery and the passage of title and risk in goods, as well as the extent to which liabilities (including warranty claims) or rights of termination might arise if the end-user products do not meet required standards as to quality or specification of goods to be supplied under a given contract
2. Insurance policies ought to be checked to ensure sufficient cover is in place to protect against risks of business interruption and product liability arising from material shortages and the sourcing of alternatives

For further information on COVID-19 and contractual penalties, please see our earlier [article](#).

## Supply Chain Visibility

**Ensuring ongoing supply chain visibility, including through supply chain mapping and supplier vetting and auditing, is of critical importance in terms of keeping goods flowing and managing/mitigating risk.** Not having sufficient visibility over sourcing alternatives could result in an increase in underlying production costs and such goods not having been sufficiently quality-tested or meeting agreed specifications, which could lead to subsequent disputes. Employees, meanwhile, could be exposed to infection from persons and goods from high-risk areas when procuring goods from alternative sources, which could, in turn, compound supply-side issues due to a decrease in productivity arising from workplace absences.

To increase supply chain visibility, businesses should consider:

1. Agreeing and implementing codes of conduct between customers and suppliers for expected standards (which govern the management of risks to the disruption of the supply chain and potentially entail an element of auditing internal processes and contractual step-in rights, etc.)
2. Ensuring that risks around product liability are otherwise covered in new or amended agreements

In doing so, and by having a more complete understanding of their total supply chain and the risks flowing from them, businesses can look to put in place more effective contingency planning and mitigation strategies ahead of time. This way, in the event disruptions do occur, companies will not find themselves in a situation where they have to catch up after the event, which can obviously come at a cost of increased expenditure, exposure to legal liabilities and/or penalties, added shareholder scrutiny and lost custom.

## Regulatory Compliance

**Monitoring compliance with guidelines or policies is an important area that a majority of respondents have yet to consider. This area is important from a liability and risk perspective,** particularly in the context of ensuring continued regulatory compliance where producers are moving stock across borders (where there may be different tax, compliance and labelling requirements) and shifting production capability away from more established areas towards new areas of (potentially higher-risk) production, such as those specifically geared towards combatting the COVID-19 pandemic.

Examples of such shifting production capability include producers of consumer products switching production to PPE equipment; chemical and drinks producers switching production to hand sanitisers; and industrial, technology and engineering announcing a switch to producing ventilator equipment.

While it is the case that, in view of the need to get equipment into production and to where it is required as a matter of priority, some requirements for PPE equipment and hand sanitisers within the UK, including CE marking, have been temporarily relaxed (and efforts are ongoing to relax regulatory requirements in relation to the approval by the MHRA of ventilators, which can ordinarily take months or years), businesses looking to switch production in order to fill gaps in the global supply chain ought to be mindful of the need to ensure effective regulatory compliance, so as to avoid unnecessarily exposing themselves to liability and risk. For businesses modifying their production lines or utilising spare production capacity to produce hand sanitiser, they may wish to consider our [guidance note](#), which details a number of the regulatory and compliance issues to be mindful of in effecting such a change.

**Another area of ongoing regulatory compliance is, of course, the health and safety of employees and third parties.** In terms of reduced activity and closures of premises, only around half of our respondents have considered the impact of factors such as reduced staffing levels in safety-critical or supervisory roles, including construction sites; how to continue with routine maintenance of closed premises, or premises being operated with skeleton staff; expiry dates of safety certificates for closed premises; disposal of waste issues; and the management of potentially dangerous substances or equipment. All of these issues may impact supply chains in the future, when activities resume and premises re-open.

As a general comment, **given the regulatory and compliance landscape is fast moving, directors ought to be particularly mindful of their legal duties** and, especially in the commercial/contractual setting, with an eye to potential future disputes and litigation.

In this regard, difficult decisions currently being taken by businesses during the COVID-19 outbreak are highly likely to be revisited in the future, once the crisis is over, and with the benefit of hindsight. It is, therefore, important that, when taking all such key and business-critical decisions, C-suite executives/boards are, so far as possible, protecting themselves, by (1) collating and maintaining good documentary records and evidence detailing the rationale behind their decision-making; and (2), where possible, maximising privilege in any legal advice received. For further information, please refer to our [boardroom dilemmas alert](#).

## Force Majeure and MAC Provisions

While a majority of respondents have yet to consider *force majeure* and MAC clauses, **an understanding of these clauses and the extent to which they apply, or could be incorporated, within contracts may prove useful in mitigating against risks, liabilities and penalties arising in consequence of disruption to the global supply chain.**

Such instances of disruption could foreseeably arise as a result of governments locking down economies and/or requisitioning supplies and facilities and producers otherwise switching production to areas that are required to fight the COVID-19 pandemic.

On the subject of *force majeure* clauses (and as more comprehensively discussed in our recent [article](#) on the subject), they are typically found towards the end of a commercial contract and seek to exclude the liability of one or more parties for events beyond their reasonable control. They can also be drafted in such a way as to provide for rights of termination in the event of non-performance of a contract for an extended period of time. Contracts are expected to define, on a case-by-case basis, what is meant by *force majeure*, whether that be by reference to specific types of events (such as fire, flood, etc.) and/or by reference to unspecified events, which are generally beyond the reasonable control of a party. Provisions most likely to succeed in the context of the COVID-19 outbreak are those that specifically name check disease or envisage such an outbreak (e.g. pandemic, epidemic wording, etc.).

MAC clauses typically provide for rights of termination of a contract where an event gives rise to a change having a material adverse impact on the business relationship. In seeking to rely on a MAC clause, due attention must be paid to the construction of the clause to ensure it can be relied upon. The potential difficulty, however, in relying on a MAC clause in the context of the ongoing COVID-19 pandemic is that materiality will need to be clearly demonstrated and it is yet to become apparent how prolonged, severe and long term the effects of the pandemic will be on business and the global economy. In addition, the need to demonstrate materiality may necessitate a detailed and lengthy enquiry, which may not be particularly conducive to a time-critical decision needing to be made to terminate a contract.

Other areas of future scrutiny, alongside *force majeure* and MAC clauses, are likely to revolve around frustration, change in law, waiver and termination arguments.

As a general comment, it is worth highlighting that clients in our network have, so far, indicated that there is a limited willingness to enforce strict legal rights (such as *force majeure* and MAC provisions) in a supply chain setting at the present time, preferring instead to resolve issues through regular dialogue and discussion. The prevailing view appears to be that the measures introduced to combat the pandemic are necessary, unlikely to be for the long term and, perhaps most crucially, there exists a spirit of “all being in this together”.

## Financial Support

While a considerable number of respondents have seemingly yet to consider what financial support is being offered by external organisations and the government to help support business, **ongoing liquidity demands and access to finance are of critical importance in keeping businesses operational and the supply chain flowing.**

In terms of support that is available, besides Chancellor Rishi Sunak’s well-publicised initiatives to support furloughed employees and self-employed workers, a range of measures have been [unveiled](#) to support businesses. Such measures include various tax and rates’ reliefs, as well as loan facilities (including loans from [accredited lenders](#) of up to £5 million for SMEs, which are backed by the government-owned British Business Bank and a new lending facility from the Bank of England to help support liquidity among larger firms by buying short-term debt).

Although efforts are ongoing to cut red tape, and banks’ lending processes are constantly evolving so funds are received quickly by companies in need (with banks such as Barclays, RBS, Lloyds and HSBC recently confirming that they will not take personal guarantees as security for COVID-19-related loans of up to £250,000), businesses should be aware that extraordinary measures have been implemented to help support them during these unprecedented times beyond more traditional sources of funding in the event they face liquidity issues. For further information, you can access our guidance notes on keeping your business [financially healthy](#) and on [tax-related reliefs and relaxations](#).

## Further Updates

We have set up a [dedicated resource hub](#) for businesses on legal, regulatory and commercial global supply chain issues.

If you would like to discuss any of the issues raised in this alert, please do not hesitate to get in touch with any of the listed contacts.

Our [contingency self-assessment planning tool](#) is still available for completion.

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