Managing the Commercial Impact of the Coronavirus: Food & Beverage

Friday, March 6, 2020

“Caution is appropriate. Preparedness is appropriate. Panic is not.” (~ U.S. Surgeon General Dr. Jerome Adams, quoted this week)

The coronavirus (provisionally named SARS-CoV-2, with its disease being named COVID-19) has been documented in six of the world’s seven continents (sparing only Antarctica), in more than 70 countries and territories. More than 90,000 cases have now been documented across the globe, resulting in nearly 3,200 deaths. In the United States, the coronavirus has impacted domestic and foreign travel, as the Centers for Disease Control and Prevention has issued a Warning - Level 3 (Avoid Nonessential Travel) for travel to China, Iran, South Korea and Italy and an Alert - Level 2 (Practice Enhanced Precautions) for travel to Japan. Many businesses have imposed restrictions on employee travel. Twitter, Amazon, Salesforce and Nike, in addition to scores of manufacturers and professional service firms, are among the companies banning certain employee travel due to the coronavirus.

At the epicenter of the coronavirus is the important worldwide manufacturing hub of Wuhan, China. The recent spread to other major manufacturing hubs further impacts the global economy and supply chains in ways not seen since the SARS outbreak in 2003. Investors reacting to the coronavirus have caused extraordinary fluctuations in the stock market, reflected in the Dow’s end-of-February plunge and its March 2nd gains, both record-breaking. The Federal Reserve made an unscheduled half point interest rate cut, in an effort to calm investors and help protect against the economic impact of the coronavirus.

At the center of the financial impact is the growing disruption to worldwide supply chains across many industries, including manufacturing, technology, solar, hospitality and travel, healthcare, food, fashion and apparel, to name just a few. China is the world’s second largest economy, and the effect of the coronavirus extends – much like the coronavirus itself – far beyond its borders. In fact, according to Fortune.com, 94% of Fortune 1000 manufacturers are being hit with disruptions as a result of the coronavirus. 1

As the coronavirus outbreak continues to develop, now is the time for food and beverage companies to consider response actions to help mitigate their risk and prepare for how they will deal with the fallout from the coronavirus. An effective plan should include establishing an interdisciplinary crisis response team to identify, assess and manage the risk presented. The team should include personnel from purchasing, operations, quality, regulatory, finance and legal.

The food and beverage industry has not been spared by the impacts of the coronavirus. Some industry players like non-perishable and processed food companies are seeing an increase in sales as customers are either by choice or by quarantine eating at home. On the other hand, retail food establishments and restaurants are facing challenges with a shortage of food supplies, employees and consumers.

In light of these events, companies in the food and beverage sector should consider taking the following steps to preempt and mitigate interruptions in the supply chain.

Continue to follow current Good Manufacturing Practices (cGMP) and appropriate Hazard Analysis Plans (HAACP and HARPPC). The World Health Organization (WHO), 2 the Food and Drug Administration (FDA) 3 and the Centers for Disease Control and Prevention (CDC) 4 have not seen evidence to suggest that animals or animal products imported from China pose a risk for spreading COVID-19 in the United States. 5 Instead, the WHO stated “it is known that food processing conditions are generally effective at destroying viruses.” Therefore, companies should remain vigilant in following cGMPs and their hazard analysis plans. If companies are sourcing food or food supplies from different suppliers or vendors, they should assess carefully if the new supply chain causes
additional hazards and, when appropriate, ensure that those companies have hazard analysis plans in place as well. Additionally, one critical aspect of both cGMP and hazard analysis is ensuring that staff are properly trained in food hygiene (and as hygiene issues are front and center generally) – employees should not touch ready-to-eat foods with their bare hands and should not be working in the establishment if they are ill.

Create Business Continuity Plans. The FDA stated that the outbreak is not currently resulting in an increased public health risk for American consumers from imported products, and similarly, export bans have not been imposed. Yet, due to the U.S. Department of State’s Travel Advisory to avoid travel to China due to the outbreak, the FDA is not conducting any inspections in China, including food facilities. Instead, the FDA is using alternative measures to monitor food safety, including importing screening, examinations, sampling (relying on a firm’s previous compliance history, and using information from foreign governments. The United States may see slower than normal processing at the border. To minimize disruption, food and beverage companies should create business continuity plans. Companies should revisit their supply chain’s design and consider sourcing goods locally to match consumer demand.

Assess Food Storage Options Early. Industries that rely heavily on selling into the food service market in China, especially if those items are perishable and require quick distribution may see reduced demand in China. For example, the epidemic is exacerbating a “meat glut in the U.S.”6 Because many U.S. meatpackers were counting on large orders from Chinese buyers, the slowdown of meat consumption internationally is causing ports to back up with products. Due to less consumption overall for these products, companies are struggling to find places to hold their products. If existing facilities do not have the capacity to hold overflow in the temperature-appropriate conditions, companies producing perishable goods should assess early on whether they have access to external storage options for their products.

Communicate with Critical Suppliers. When the response team identifies critical suppliers (such as single source ingredient suppliers), companies should consider proactively reaching out to those suppliers to determine what level of inventory they are carrying and what actions the suppliers are taking to prepare. Further, companies should consider whether reformulation or changes may be necessary in the event certain ingredients may be limited or unavailable and, in each case, may be feasible from an operational, timing, and cost perspective.

Review Purchase and Supply Contracts to Determine What “Force Majeure” Rights and Requirements May Apply.7 Force majeure refers to a legal doctrine under which a party may be relieved from liability for non-performance if circumstances beyond the party’s control prevent the party from fulfilling its obligations under a contract. Force majeure provisions can vary greatly depending on how they were drafted by the parties, but they usually cover several categories of events that could impact suppliers and customers across the supply chain. While most force majeure provisions are unlikely to list disease, epidemics or quarantine specifically, many include general provisions covering such things as natural disasters, “acts of God,” acts of government or “other circumstances beyond the parties’ control.” The coronavirus outbreak presents a somewhat unique situation in that it includes both a naturally occurring component (the virus itself) and a government action component (including the quarantines and other measures put in place in response to the outbreak). Companies should carefully review the force majeure provisions in their contracts to determine whether they apply. Companies seeking to invoke the force majeure provisions in contracts usually must show that there are no alternative means for performing under the contract, as increased costs alone often will not be sufficient to prevail on a claim of force majeure.

Monitor Customer Demands. Companies should monitor downstream customers to ensure that they will comply with their contractual obligations, including timely payment for products supplied to the customers. For those customers with a greater risk of nonpayment, companies should analyze contractual payment terms. Companies should then evaluate whether to seek to enforce remedies available to a seller of goods under the Uniform Commercial Code, including demands for adequate assurance of payment or a change in payment terms.

- **M&A Agreements.** Companies that are parties to definitive M&A agreements should review the contract terms, including any “Material Adverse Change” (MAC) clauses as well as representations and warranties, to assess the potential impacts of the coronavirus on their transaction. For attorneys drafting and reviewing definitive M&A agreements, care should be taken in crafting or reviewing appropriate MAC clauses, representations and warranties and other provisions to take the potential impacts of coronavirus into account. On the buy side, enhanced focus on supply contract due diligence is recommended.

- **Reporting Requirements.** Public companies should review and make accurate required disclosures in the event that business operations are impacted such that a reporting requirement is triggered. All companies that are parties to credit agreements and other financing arrangements should review existing MAC clauses, and potential impacts on the borrower’s financial covenant compliance, in order to determine whether any proactive conversations with lenders may be warranted.

- **Insurance.** Companies should review insurance policies to determine possible coverage in the event of a business disruption and comply with all applicable notice requirements.

- **Employment Concerns.** The challenges for any business facing coronavirus or other disease outbreak involve a multitude of conflicting legal obligations. Under the Occupational Safety and Health Act (OSHA) and similar state laws, employers have a general duty and obligation to provide a safe and healthy work environment, even when the work occurs outside the employer’s physical premises. Furthermore, under these health and safety laws, employers must not place their employees in situations that are likely to cause serious physical harm or death. Conversely, overreacting by implementing broad-based bans and making business decisions about employees that are not based on statistical realities could get an employer sued under laws that prohibit discrimination based upon disability (perceived or real) and national origin, among others. Properly planning for and implementing plans to deal with the coronavirus is legally and operationally complex. For more information on specific action employers should take, please [click here](https://www.foley.com/en/insights/news/2020/02/uetz-quoted-fortune-impact-coronavirus-auto).

In summary, it is important for food and beverage companies to take additional steps now in order to mitigate their risk of suffering negative impacts from the coronavirus. For more information about recommended steps, please contact your Foley relationship partner. For additional web-based resources available to assist you in monitoring the spread of the coronavirus on a global basis, you may wish to visit the [CDC](https://www.cdc.gov) and the [World Health Organization](https://www.who.int).

---
