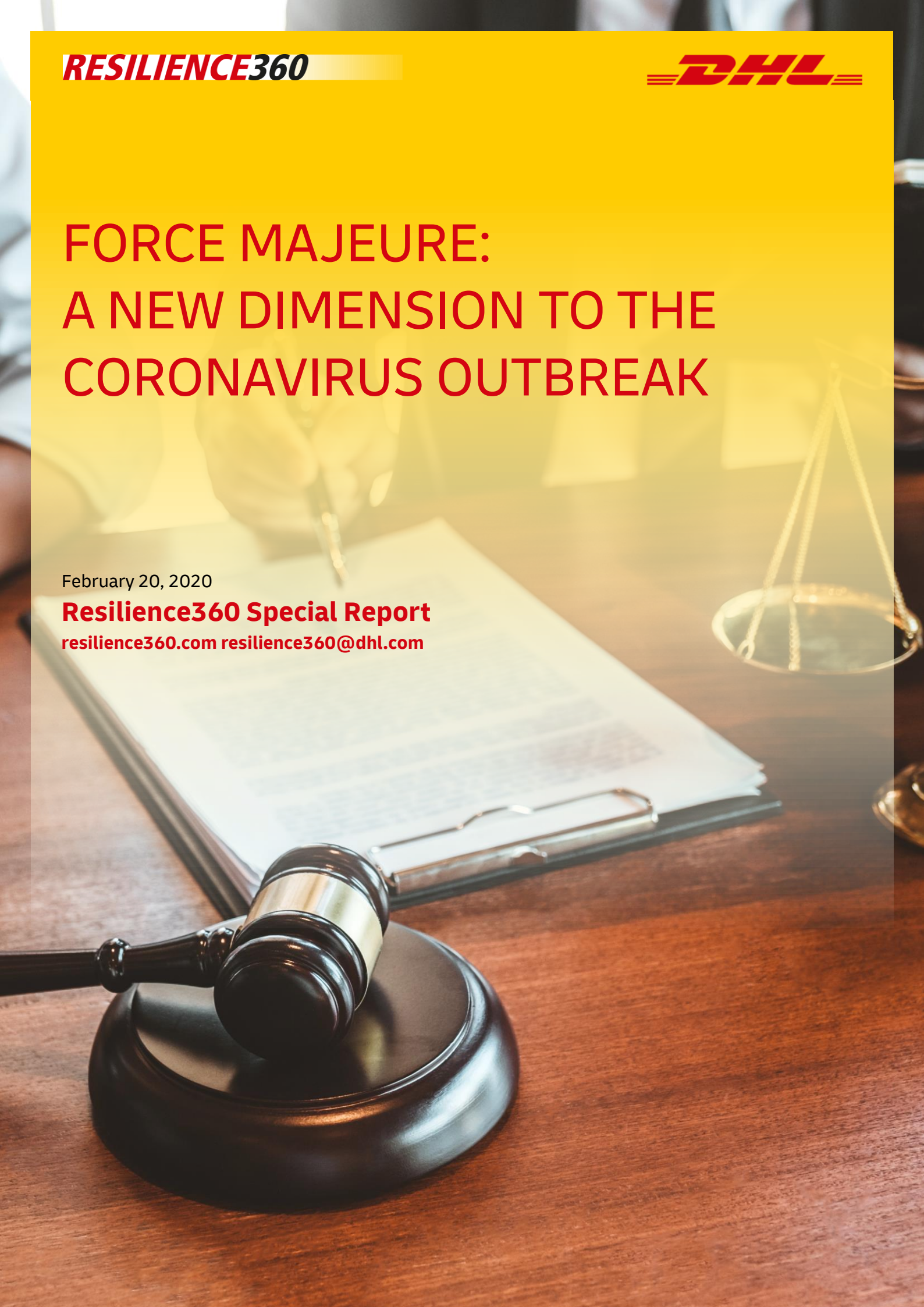


FORCE MAJEURE: A NEW DIMENSION TO THE CORONAVIRUS OUTBREAK

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Resilience360 Special Report

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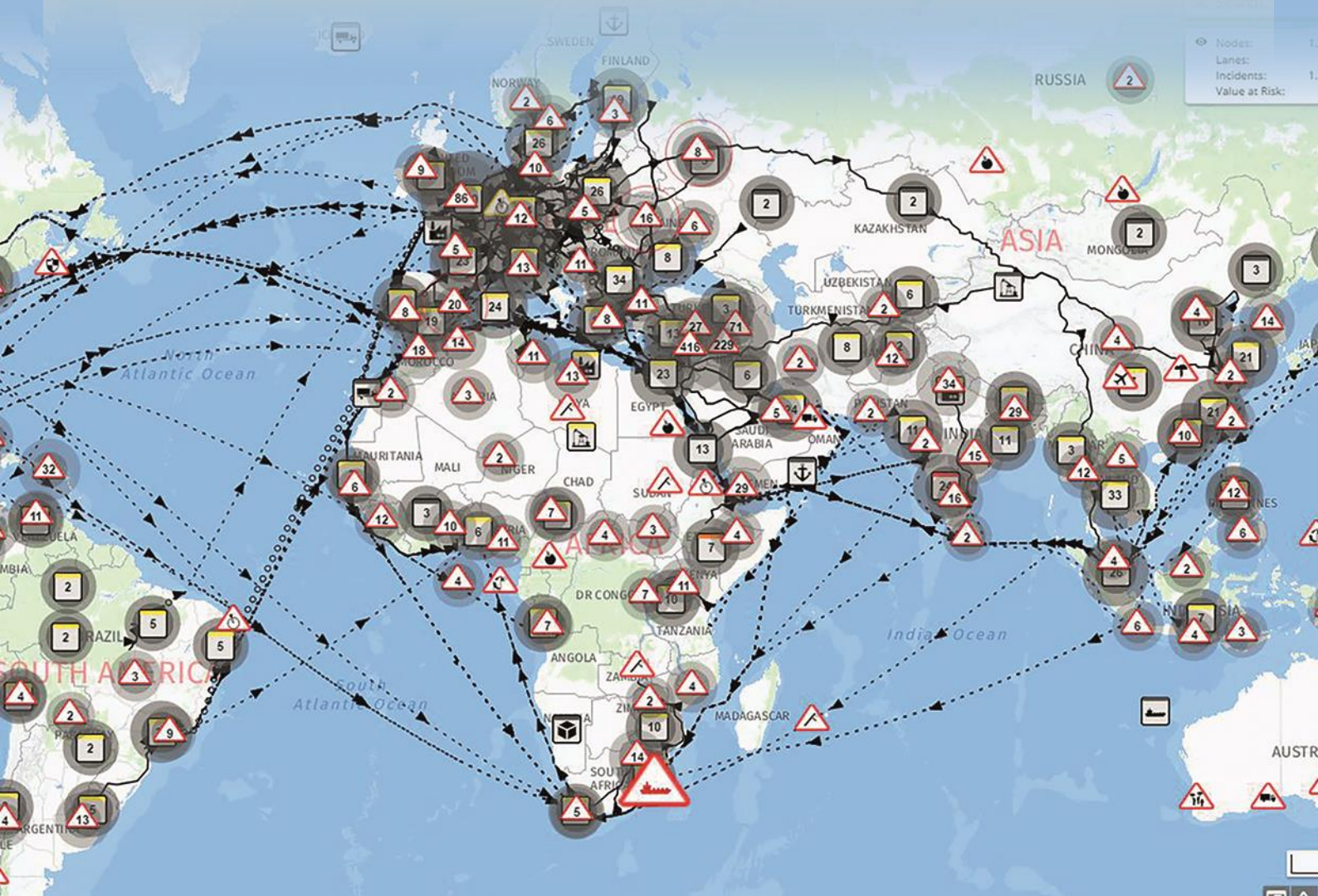


BACKGROUND

With production and logistics operations across China gradually resuming, supply chain managers across industries like automotive, machinery, and chemicals may soon face a new risk dimension pertaining to the coronavirus outbreak: suppliers or buyers invoking force majeure. As authorities seek to provide financial and legal support to companies struggling with the coronavirus fallout, the China Council for the Promotion of International Trade (CCPIT) has already issued force majeure certificates to 1,615 companies covering 30 sectors and a total contract value of RMB 109.9 billion (USD 15.7 billion; EUR 14.5 billion) until February 16.

These certificates shield companies from legal and financial damages arising from not performing or only partially performing contractual duties, such as delivering, transporting, or taking cargo, by proving that they are experiencing circumstances beyond their control. Typically, force majeure is invoked during natural disasters but can also apply in the event of unforeseen acts of government such as the government-mandated lockdowns and production stoppages in the wake of the coronavirus outbreak.

ABOUT RESILIENCE360



Resilience360 is an innovative, cloud-based platform that helps companies to visualize, track and protect their business operations. The solution facilitates intuitive supply chain visualization, tracks shipments and ETAs across different transport modes and enables near real-time monitoring of incidents capable of disrupting supply chains. Resilience360 easily integrates with business systems and helps companies keep track of risk in combination with their business performance indicators. It enables companies to better ensure business continuity, building risk profiles based on over 30 risk databases, and identifying critical hotspots using heat-maps to mitigate risks and to turn potential disruptions into a competitive advantage.



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WHY ARE FORCE MAJEURES SIGNIFICANT?

Although only a small number of companies have so far received such certificates, the numbers could quickly rise in the coming weeks as more companies realize that they cannot deliver or receive cargo due to labor shortages and logistics challenges even though they are allowed to resume operations. In addition, the Chinese government has instructed six trade associations in sectors like textile, mining, machinery, and medical devices to support with legal counseling and applying for force majeure certificates, which will likely result in more force majeure declarations in the coming weeks.

As a consequence, trade relationships with Chinese or foreign companies operating in China could become entangled in legal and financial disputes which may either be solved by an independent arbitration body or through a negotiated compromise. This could take several months due to the constantly changing regulatory environment in China.

What makes the topic of force majeure even more significant is that both its use and its consequences are likely to hit the supplier and the buyer at the same time. For instance, a car manufacturer in China or abroad may have to deal with Supplier A invoking force majeure due to its inability to deliver parts, which prevents the car maker from producing its end product as no alternatives are available in the short term. Major OEMs such as BMW, Daimler, and Fiat Chrysler as well as Toyota, Nissan, and Hyundai have all halted production in China and some in their domestic markets. The car maker is then likely to invoke force majeure on its own for component deliveries from Supplier B which is still able to produce and deliver, since these components are of little value due to the car maker's production lines being down.

WHICH SECTORS ARE MOST AFFECTED?

Since early February, some companies like Taixing Jinjiang Chemical Industry Co. Ltd., which produces biofuels and industrial chemicals, have started to declare force majeure to their customers. However, it was not immediately clear whether this company or others that declared force majeure shortly after such as China National Offshore Oil Corporation, Guangxi Nanguo Copper, Jiangsu New Times Shipbuilding and Jiangmen Handsome Chemical had already received force majeure certificates from the China Council for the Promotion of International Trade (CCPIT), whose certificates are recognized by governments, customs, trade associations, and firms from more than 200 countries worldwide.

According to the CCPIT, Zhejiang-based Huida Manufacturing (Huzhou) Co., which supplies steering-system components to a PSA Group plant in Africa, was the first company to receive a force majeure certificate on February 2. The identities of other companies that have received the certificates have not been formally revealed through either Western or Chinese-language media sources.

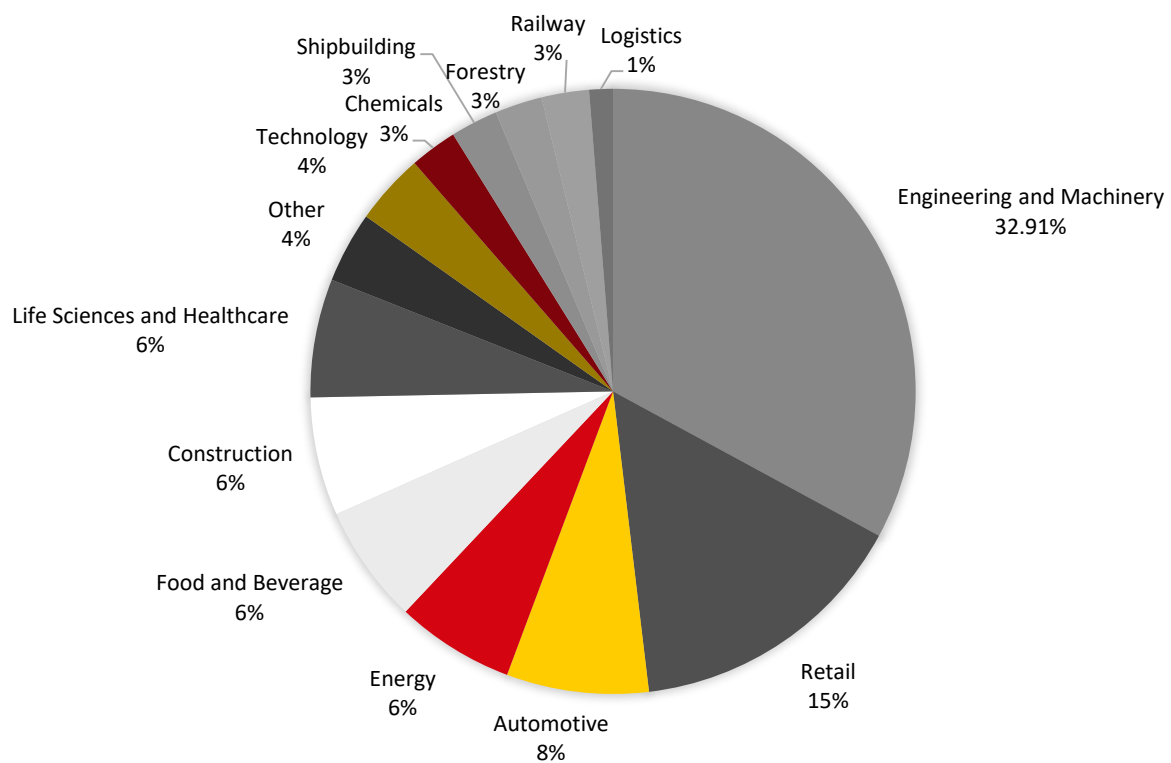
However, original analysis of Chinese-language documents by Resilience360 shows that force majeure certificates were delivered to companies in different Chinese provinces across various sectors, including in the chemical, automotive, medical devices, and electronics sectors.

Most of these certificates have affected companies in the machinery sector (32.91 percent) that produce tunneling and mining equipment as well as machines for lithium battery production and printing, among others. Companies in the retail sector that produce, distribute, or export apparel products, gifts or accessories account for 15 percent of the recipients of such certificates.

Among other notable industries are companies in the automotive and energy sectors, which have each received 8 and 6 percent of force majeure certificates respectively. The former includes Xinxiang Aidiwei Automotive Technology Co. Ltd, a vehicle parts manufacturer from Henan Province, while the latter comprises of Hubei's Yihua Chemical Industry which produces urea, diammonium phosphate, liquid nitrogen, and chlorine products. Diammonium phosphate is the world's most widely used phosphorus fertilizer made from two common constituents in the fertilizer industry.

WHICH SECTORS ARE MOST AFFECTED?

BREAKDOWN OF COMPANIES THAT REPORTEDLY RECEIVED FORCE MAJEURE CERTIFICATES BY SECTOR



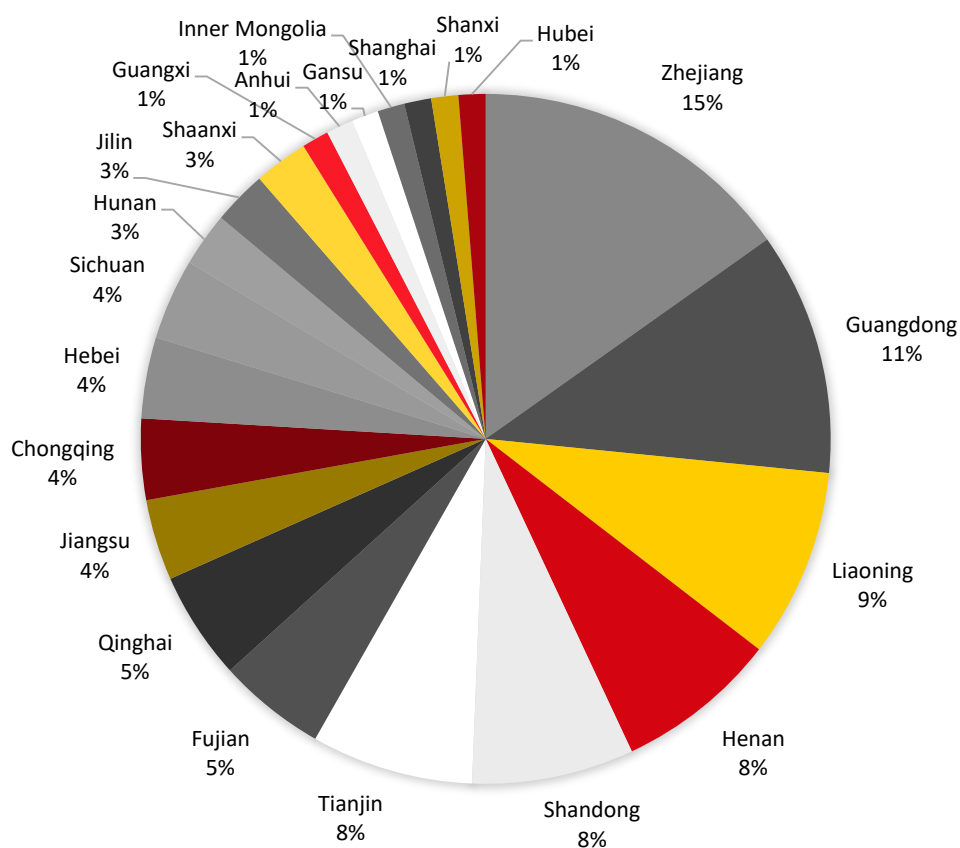
Source: Open-source research by Resilience360

WHERE ARE MOST OF THESE COMPANIES LOCATED?

A geographic breakdown shows that most certificates have been issued to companies in Zhejiang Province, a province in Eastern China, which has experienced a high number of infected cases and whose cities were among the first outside of Hubei Province to impose lockdowns on residents. Many machinery manufacturers along the province's coastline like Ningbo Weipeng Electric Company Ltd. have declared force majeure in recent days. The low number of force majeure certificates issued for companies in Hubei Province, the epicenter of the coronavirus outbreak, may be explained by the fact that production remains prohibited and employees are still locked out of the province or under quarantine at home. The southern Chinese province of Guangdong, a major hub for electronics manufacturing, accounts for 11 percent of force majeure certificates, likely due to stricter rules for companies that seek to resume production. Most prominently, Guangdong Changhong Electronics Co. Ltd, a maker of high-end TV sets and displays, received a certificate from the city of Zhongshan near Guangzhou on February 3. Guangdong is followed by Liaoning Province with 9 percent as well as Henan, Shandong and Tianjin which make up for 8 percent each.

WHERE ARE MOST OF THESE COMPANIES LOCATED?

COMPANIES RECEIVING FORCE MAJEURE CERTIFICATES BY PROVINCE



Source: Open-source research by Resilience360

WHAT CAN COMPANIES DO TO PREPARE?

- **Set up a central crisis team:** Companies should set up a virtual emergency management center that keeps up with the latest news on the outbreak, the changes in government regulations, and new potential supplier outages.
- **Locate affected suppliers and assess impact:** Once force majeure is declared, companies should identify which tier within their supply chain the affected supplier is located and what the revenue impact will be due to lost sales triggered by missing components or materials and halted production lines.
- **Seek alternative sources or capacity:** If a critical supplier is down, organizations should explore if inventory remains at sufficient levels or if alternative sources are available in the short term. Securing air freight capacity for critical parts can also be a viable option. iPhone maker Foxconn reportedly flew critical components from China to its factory in Vietnam to keep production lines running.
- **Maintain communication with key stakeholders:** Keeping in touch with your suppliers or buyers is essential to work out alternative plans such as fulfilling orders at a later date without facing legal liabilities. In most cases, finding a negotiated compromise may be the preferred option. Of equal importance should be to provide regular updates to key internal and external stakeholders, including contract formulators to check or re-calendarize production runs.
- **Explore legal options:** If a negotiated settlement is not considered viable, companies should review the contracts to determine what rights and remedies they have as a result of the delayed performance or refusal of contracted services.