

## Daily Memo: COVID-19, Force Majeure And The Coming Wave Of Supplier Renegotiations

By Michael Bruno, April 9, 2020

**W**hen Boeing shut down its Puget Sound and South Carolina aircraft production this week due to COVID-19 concerns, the aerospace and defense (A&D) giant made a quick reference to “the reliability of the supply chain” as one reason.

Suppliers across A&D quietly are reporting worker absences of 25-50% in light of the coronavirus pandemic fears, according to Vivek Saxena, MD at Advisory Aerospace. Such absenteeism puts a damper on productivity, of course, and because of that and other related issues, Jeff White, a partner at the Robinson Cole law firm in Hartford, Connecticut and New York City, says he is seeing a spike in work “pause” letters flying around the A&D supply chain.

But White thinks that is just the beginning of a legal tsunami. A lawyer based in the heart of the New England aerospace manufacturing hub where he has been working with suppliers for years, especially sub-\$100 million revenue machine shops feeding engine-makers, White is gearing up for an expected onslaught of force majeure suspension claims that, along with other contractual nitpicking, could be cited widely to allow OEMs and suppliers alike to try to renegotiate contracts as aerospace manufacturing follows the falloff in air travel.

“COVID-19 has accelerated the use of it,” White tells Aviation Week. “What we’re seeing is the advance warning that something is coming.”

According to law firm Shearman and Sterling, a force majeure provision typically relieves a party from what would otherwise be a breach of contract—i.e. its failure to perform a contract obligation due to the effects of an extraordinary event. The party must establish the causal link between the event and its inability to perform.

COVID-19 seems ripe for citing. With some variant of shelter-at-home mandates in almost every state in the U.S., and companies reporting virus-infected staff, the pandemic has disrupted the whole country. But force majeure is supposed to be a temporary suspension—at some point, if not lifted, it kills a contract. It is supposed to be a defensive mechanism but White thinks it could become a weapon to kill existing obligations as aircraft and engine OEMs slash production rates.

“Do people use force majeure in the COVID-19 situation to basically delay and run out the clock, and then say, ‘you know what, we really never needed these parts anyway,’” he asks rhetorically. White believes so, and for good reasons: commercial transport and manufacturing was seeing a slowdown for about a year before the coronavirus.

Aerospace consultant Richard Aboulafia of the Teal Group noted in several conference presentations earlier this year how air travel was slowing below long-term averages starting March 2019. That, along with slowing economies such as China’s suspected near-stall last year, traditionally drive down aero manufacturing activity.

For much of the past post-Great Recession rise in aerospace, suppliers were not paying as close attention to their contractual fine print because everyone was enjoying the historic super-cycle in airliner orders and deliveries, according to White. Then, starting about eight months ago before the novel coronavirus outbreak, he and other lawyers started fielding interest from supplier clients who were responding to OEM cost-cutting efforts starting more than a year earlier. The goal of these maneuvers is not to wind up in court and ruin relationships in the tight-knit aero manufacturing world, but rather just to be able to ratchet down existing long-term agreements (LTAs).

“There were already these trends in the industry that were already causing changes—there were already winners and losers, and COVID-19 is going to exacerbate and create opportunity,” White says. “We are going to see dozens and dozens of stories of companies using COVID-19 to cover up their massive problems. People are cleaning house.”

In a recent IndustryWeek article and again with Aviation Week, White recommends suppliers pay attention and prepared to the following actions:

- Force majeure: be proactive and document issues before a dispute occurs, if possible;
- Cost-savings: make sure the language in your LTAs gives you room to develop process changes that will improve your margins while providing a nominal cost cut to your OEM;
- Quality and delivery metrics: be prepared for a formal letter scrutinizing your metrics with a dollars’ penalty included;
- Materials costs: review the distinction between an OEM directed-buy agreement or supplier purchase and the risk of materials cost increases;
- Scrap: be ready for OEMs seeking value from the leftover raw material they may have helped buy; and
- Volume guarantees: while having LTAs may be comforting know that OEMs will seek second sources long before your LTA expires.

“These LTA issues, they are going to be supercharged. It’s a pre-COVID trend that will only be increased by what’s going on right now,” White tells Aviation Week. “Everybody up and down the supply chain and their brother is looking at contracts to see how they can slow production.”