How COVID-19 May Rattle Companies' Supply Chains

By **Zal Phiroz**

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Supply chain management is a term which is often misunderstood as being solely relevant to one aspect of a business. In fact, an efficient and effective supply chain plays many crucial roles in the processes of production and distribution.

This is clearly reflected through the attention afforded to the overall study of supply chain management, and has a direct impact on business competitiveness, flexibility and innovation. The overarching objective of a supply chain is to ensure products are provided to customers in a timely manner, at the lowest possible cost.

Within global supply chains, coordination and customization is complex, and requires the consideration of multiple factors — including all demand and supply points within the network, fixed operating costs of each distribution or retail facility, revenue generated per customer location, and facility, labor and construction costs.

Recent disruptions due to COVID-19 have made it important to consider numerous supply chain vulnerabilities and related legal concerns, as entities including factories, storage locations, distribution systems and retailers begin to resume their activities.

Insufficient Quality Control Standards

Companies may engage in numerous strategies to reduce production and manufacturing costs. Outsourcing production is one method by which companies may take advantage of lower labor cost and less restrictive labor practices.

While this practice may result in lower overall costs, even in consideration of transportation, tariffs, etc., the tradeoff is a lack of production control. This can potentially result in a number of detrimental consequences, including loss of brand image, damaged relationships between vendors and consumer injury. Given the international shipping and distribution restrictions as a result of COVID-19, many companies may have faced unexpected quality assurance issues as production and transportation tiers were halted.

One prominent example of how outsourcing can lead to a loss of quality control is the 2007 class action lawsuit involving Mattel Inc. and Fisher-Price Inc.[1] Concerns about lead-based paint and magnets which could become loose led to recalls of more than 20 million toys.

Production had been outsourced to Chinese manufacturers with lenient quality control, resulting in products that were noncompliant with U.S. safety standards. Specifically, the case alleged that certain toys were manufactured with unsafe levels of lead paint, and other toys included small, swallowable magnets. The toys were recalled at the order of the U.S. Consumer Product Safety Commission.

A class action was filed against Mattel and Fisher-Price, alleging violations of tort law under theories of strict liability and negligence, violations of contract law for breach of express and implied warranties, and violations of the federal Consumer Protection Safety Act, the California Consumers Legal Remedies Act, California's unfair competition law and the Song–Beverly Consumer Warranty Act.

Ultimately, the case was settled, with Mattel agreeing to compensate toy buyers at a total cost of over $50 million. Mattel was also required to create a quality assurance program overseen by the court. Mattel subsequently made a number of changes, including internal manufacturing, use of certified vendors and increased inspections. The impact this recall had on Mattel's brand image, relationships with vendors and ability to project demand in future periods was notable.

The Mattel recall demonstrates the need for companies, when outsourcing production, to consider the importance of consumer safety, and compliance with both federal and state consumer protection standards. Additionally, to minimize risk related to component parts, which were at issue in the Mattel case, companies should consider including contract clauses that provide access to the supplier's test data.

In resuming operations after pandemic-related shutdowns, companies may be inclined to expedite various areas of the supply chain in order to rescue their previous market share. This could impact production and product design, and could lead to the reduction of product safety measures in various stages of fulfillment. The result could be compromises in product quality, including product defects or a shorter product lifespan, which could create the potential for consumer injury.

While these problems may occur in product development and manufacturing, other phases of the supply chain might also be impacted, including storage and distribution stages.

Overproduction and Unsafe Storage

One of the main areas of consideration within a supply chain is the forecasting of demand. Finished and unfinished products are often held at various points in a supply chain — e.g., warehouses, distribution centers, retailer storage facilities, etc. — for strategic business purposes — e.g., hard product conversions, scheduled product launches, etc.

Products may be stored in an effort to meet perceived customer demand, and to hedge against unanticipated demand fluctuation. Given the current likelihood that various entities within the supply chain may have closed for a period of time, there may be buildup of product — and with renewed efforts to to expedite the distribution and sale of product, safety issues arise.

The incorrect storage of products, both finished and unfinished, could lead to problems with product quality. Numerous phases of the supply chain may be implicated in this regard, as product may be stored by various entities across the chain.

In particular, certain products have specific storage requirements — controlled temperature, stackability restrictions, etc. — and not paying attention to these requirements may contribute to problems with product quality. Companies should be particularly mindful of changes in storage conditions, and the potential implications for product quality and safety.

If product integrity is compromised, and not properly addressed, companies could open themselves to increased tortious liability, particularly product liability claims. Product liability

cases are governed by state law, and are often brought under theories of negligence, strict liability or breach of warranty. In order for plaintiffs to bring a case under any of these theories, they must show that the product was defective and that it caused an injury.

The best way to reduce the possibility of liability is for companies to test the product, and its component parts, in a variety of circumstances. Quality control typically takes place throughout the supply chain, and each tier of the supply chain typically assumes specific responsibilities — design, manufacturing, storage, distribution, etc. Product-specific storage, temperatures, shelf life, etc. should be tested by the appropriate entities in the supply chain.

Inefficient Distribution and Transportation of Products

As supply chains become extensive, product transportation needs become more complex. Often supply chains rely on multiple methods of transport — e.g., freight, rail, truck, etc. The use of multiple transportation methods may open the door for compromises to product quality and safety.

One interesting example is liquid laundry detergent. If transported in nonheated trailers, the liquid may freeze. When thawed, it often does not return to its original consistency. While this may not be a product safety concern, since the product still functions as required, the image of the brand, and the perceived level of product quality, may suffer.

As a result of COVID-19, many more purchases are being made online. So last-mile fulfillment — the final step of delivery, where product is delivered to a consumer's doorstep — has come into greater focus. While this process may seem relatively seamless, it involves a modification of the traditional retail-facing supply chain model. Thus, it could potentially present product quality vulnerabilities, as nonspecialized delivery processes might be used.

COVID-19 has presented the market with a range of new distribution challenges. Parties rely on negotiated contract terms to regulate the flow of products. In adjusting to the changing markets, companies may be forced to reexamine contracts, renegotiate terms or even breach contracts in their entirety.

These decisions inherently open a company to increased litigation risks. For example, if a company is not able to produce at its normal output, it may need to fulfill certain contracts and breach others. In order to minimize overall exposure, a company should take into account all contractual obligations, and determine the contracts where a breach will result in the least amount of penalties.

Limitations of a Reduced Workforce

As a result of COVID-19, entities throughout the supply chain have experienced layoffs and staffing reductions. As business begins to resume, there continues to be concerns over employee contamination of products.

According to data from the Food and Environment Reporting Network, Tyson Foods Inc. has had nearly 10% of its workforce test positive for COVID-19. When an employee tests positive for COVID-19, there are a number of legal questions that the company may encounter including employee leave requests the company's obligations to provide various types of paid and unpaid leave.

Additionally, in response to COVID-19, the Families First Coronavirus Response Act provides

eligible employees with emergency paid sick leave. From a supply chain perspective, fewer employees could result in a slower processing cycles — which could impact the flow of distribution and manufacturing, and in turn could affect lead time projection. In the long run, this could potentially influence demand, which may be detrimental to the company overall.

These concerns, in concert with lowered revenue expectations, may provide businesses with an incentive to resume operations with a smaller workforce. But lowered staffing levels — especially in the production arena — could lead to a lowered ability to monitor and maintain quality control standards.

Operating with a reduced workforce may create additional constraints on companies and open them to employment-related liability. To minimize potential exposure, companies should review their practices and policies, including but not limited to wage and hour requirements, employee leave requests, employee benefits, unemployment compensation, workplace safety and discrimination protections.

Conclusion

The practice of gaining a competitive advantage through supply chain optimization is not new. But it can leave companies vulnerable to problems related to product safety, product quality, product longevity and product sustainability.

These problems are compounded as businesses resume operations after COVID-19 lockdowns. As businesses push to resume production, and reclaim lost market share, product design, manufacturing, storage and quality assurance may suffer — which could result in product damage and consumer injury.

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[1] In re Mattel Inc., 588 F. Supp. 2d 1111 (C.D. Cal. 2008).