Protecting Your Company in a Trade War

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New international trade disputes have been occurring on almost a weekly basis. Actions on Chinese unfair trade practices, steel and aluminum tariffs, NAFTA amendments, auto tariffs, solar panel safeguards and foreign retaliatory actions are all underway. These can result in increased costs, lost customers and long term structural changes in your business. Driven by strong political forces, they do not seem to be abating any time soon.

It is important to understand the impact these disputes are having on your business and steps to take to protect it. What follows are a number of steps senior executives and trade professionals can take to analyze the impact of the recent trade cases on their companies and develop an action plan for responding to them.

I.   BACKGROUND OF THE INTERNATIONAL TRADE DISPUTES

The Trump Administration has initiated a wide array of trade actions within the past year. These include (i) tariffs on imported steel products (25%) and aluminum products (10%);[1] (ii) tariffs of 10%-25% on over 1,000 consumer and industrial products from China;[2] (iii) renegotiation of NAFTA (now called the U.S. Mexico Canada Agreement); (iv) investigation of possible tariffs on automobiles and auto parts[3] (v) 50% tariffs on imports of steel from Turkey;[4] (vi) investigation of possible tariffs on uranium imports;[5] (vii) safeguard tariffs on solar cells and modules;[6] and (viii) tariff-rate quotas on Residential Washing Machines.[7] Many foreign countries have also imposed retaliatory tariffs on a wide array of U.S. products in response to the U.S. tariffs.

The purpose of the U.S. trade actions has been to apply pressure on foreign countries to improve foreign market access for U.S. exports, and to increases U.S. jobs at home. It is unclear, however, if these actions will be successful, and they could actually be harmful to U.S. companies by increasing manufacturing costs, reducing U.S. exports and slowing the U.S. economy.

At first many business executives thought these trade disputes were just short term political events that would evaporate quickly. But many are now recognizing that these changes may be around for an indefinite period and have begun planning for their long term impact.

II.   ANALYZING THE IMPACT OF THE TRADE ACTIONS

As a first step it is important for U.S. executives to monitor the trade actions carefully and develop a clear understanding of changes being enacted. Some of these actions, such as auto industry tariffs, are still under investigation and may not be implemented for months. Others, such as the tariffs on steel, aluminum and Chinese products, have already gone into effect. Bear in mind that changes are occurring on an ongoing basis (for example the 10% tariffs on List 3 Chinese imports will increase to

25% on January 1, 2019) so it is important to stay up to date. It is also important to distinguish between the political threats and rhetoric of political leaders from actual changes in the law.

Once you have identified the specifics of recent amendments, you should analyze the impact these will have on your company. How much will increased U.S. tariffs cost your company in purchasing raw materials and components? How much will increased foreign retaliatory tariffs reduce your exports and revenues? Will purchasing substitute components result in increased costs and supply chain delays? What is the cumulative effect of these changes on your bottom line? The trade actions are having widely different effects on different U.S. industries – certain sectors such as retail, electronics and manufacturers that use steel or aluminum are being impacted significantly, while others will experience only minor effects. The impact on your company might not be as bad as you thought, or it could be significantly worse.

III. ACTION PLAN - TACTICAL STEPS TO PROTECT YOUR COMPANY

Once you have determined the impact the tariffs will have on your company you can prepare your game plan to respond. The following are a number of tactical steps to consider as part of your strategy.

1. Substitution of Products From Low Tariff Countries. If your company imports raw materials or components that have become subject to increased tariffs, consider changing to suppliers of such products that are located in countries with lower U.S. import tariff rates. For example, with the increased 10%-25% duties on certain Chinese-origin products,[8] many companies are looking to alternative suppliers in Vietnam, Singapore, Mexico and other low cost countries. Clearly changing suppliers can be time-consuming and disruptive to a just-in-time manufacturing process. However the longer increased tariffs remain in place, the greater the justification for a change in the supply chain - it may be prudent to begin assessing alternative suppliers if you have not already done so. This is especially the case, for example, if tariffs on the List 3 products in the China §301 case increase to 25% on January 1, 2019 and tariffs are expanded to cover additional Chinese products as threatened by the President.

When considering shifting purchases to countries with lower U.S. import tariff rates, however, you should use care to confirm the true country of origin of the product for purposes of duty calculation. Just because a product is shipped through Singapore does not mean that Singapore is the country of origin - U.S. Customs and Border Protection ("CBP") has strict rules for determining the true origin of a product and if it has been subject to "substantial transformation" in other countries en route to its final destination. Companies should use care in determining the country of origin in accordance with Customs requirements to insure correct reporting of information in Customs filings.

2. Changes In Level of Assembly For Imported Products. In certain instances tariff rates on components or a partially assembled product may be different than the tariff rate on the finished product. In such cases, companies may change the country of assembly/manufacture for an item in order to reduce the U.S. import duty ultimately paid. If for example the tariff on a finished product is lower than the duty rate on its components, the importer may elect to assemble the components overseas and import the finished product to reduce the duties. Consider changing the level of manufacture/assembly of imported items, including partial assembly overseas, to achieve a lower overall U.S. import duty rate.

3. Accelerate Timing of Purchases. If the company imports materials/components that will become subject to higher tariffs in the near future, consider increasing purchases and imports of such products before the higher tariffs go into effect.

4. Submit Product Exclusion Requests. Under certain of the trade actions, parties are permitted to submit exclusion requests or comments to request that their products be exempted from increased

tariffs. For example, under the China §301 action parties were permitted to submit exclusion requests for List 1 and List 2 products, and submit comments and testimony for List 3 products.[9] Similar procedures are available for the steel and aluminum tariffs under the §232 action. Consider submitting such requests to have your products removed from coverage. Factors to be addressed in such requests typically include whether a product subject to the tariffs is not available through U.S. domestic production, whether the tariffs will cause disproportionate economic harm to the applicant and whether the increased duties will be effective to achieve the policy goals stated in the trade action.

5. Review Other Traditional Duty Saving Techniques. Consider other practices that importers commonly utilize to reduce duties in their supply chains including use of bonded warehouses, foreign trade zones and sub-zones, duty drawback and similar techniques. In addition, confirm the accuracy of the tariff classifications for the company's products that will be subject to increased duties. (It should be recognized, however, that CBP will be scrutinizing changes in classifications very closely and you should have a solid legal basis for any changes made in classifications of your products.)

6. Amend Contracts and Terms of Sale For Future Purchases.   The possibility of significant tariff increases is now a major risk in international trade transactions. Consider amending your company's purchase contracts, terms of sale and purchase orders (for both export and import transactions) to address the risk of significant changes in tariffs and other trade restrictions. Such amendments might include, for example, a provision that if the company has responsibility for paying import duties, if such duties are increased above a certain specified level the company has certain rights including the right to cancel its obligation to purchase the product or to make adjustments to the purchase price. Such clauses are particularly valuable in long term contracts or transactions with long lead times prior to delivery.

7. Review Contracts To Confirm Which Party Is Responsible For Duty Payments. In import transactions, parties typically designate which party has the legal responsibility for payment of import duties in their contract, purchase order or terms of sale. This issue is often addressed under the defined terms of sale under Incoterms, or in the contract documents themselves. In the event of imports with significant increases in import tariffs, the company should review its contract documents to confirm which party is responsible for duty payments and if there are any legal grounds available to shift this obligation to the supplier rather than the company.

In addition, in many contracts "force majeure" clauses are included to excuse parties from performing under the contract due to unforeseen events such as labor actions, fires/storms, acts of god and certain government actions. In certain instances, such clauses could cover acts of government imposing trade restrictions such as import quotas and unreasonably high import tariffs. (Whether such clauses will apply to increased duties is typically a matter of state law applicable to the transaction in question and the exact language of the clause itself.) If the company wished to be excused from performing under a contract to purchase products with significant duty increases, the company should review the force majeure clause in its purchase contract to assess if this would provide a basis to be excused from performing under the contract.

8. Stay Close To Customers and Suppliers. If you change suppliers due to tariff increases, stay in close contact with the legacy suppliers to maintain your business relationship during the period in which the higher tariffs are in effect. The increased tariffs will eventually come to an end, and you may want to resume your previous purchasing as quickly as possible. The same applies if you lose customers due to price increases from increased tariffs or foreign retaliatory tariffs – try to maintain ongoing communications so that when the tariffs are removed you can move quickly to resume your previous relationship.

9. Comply Carefully With U.S. Customs Law Requirements. While many U.S. companies are taking defensive actions to deal with increased tariffs, it is important to fully comply with Customs laws in taking such actions. CBP will be looking very closely at import transactions in the coming months to

identify parties that are attempting to wrongfully evade the increased tariffs - including through improper reporting of country of origin, incorrect classifications and valuations and other false statements made on Customs filings. Under Customs law, importers are required to comply with the "reasonable care" standard in conducting import operations and violations can result in strict civil and criminal liability for importers. (In addition, under the Trek Leather[10] case, officers and directors can also have personal liability for a company's import violations.) Companies should use the highest level of care in understanding and complying with these requirements in any actions taken to mitigate trade restrictions.

10. Get Involved. Become engaged with members of Congress and the Administration to express your views on the trade actions and if appropriate voice your opposition. While it is unclear how much influence such actions will have on the President in the short term, the views of the business community have historically been an important factor in shaping U.S. trade policy in the long term.

This article contains general, condensed summaries of actual legal matters, statutes and opinions for information purposes. It is not meant to be and should not be construed as legal advice. Readers with particular needs on specific issues should retain the services of competent counsel. For more information, please visit our website at www.williamsmullen.com or contact Thomas B. McVey, 202.293.8118 or tmcvey@williamsmullen.com.

[1] Implemented under §232 of the Trade Expansion Act of 1962.
[2] Implemented under §301 of the Trade Act of 1974;
[3] Implemented under §232 of the Trade Expansion Act of 1962.
[4] Implemented under §232 of the Trade Expansion Act of 1962.
[5] Implemented under §232 of the Trade Expansion Act of 1962.
[6] Implemented under §201 of the Trade Act of 1974.
[7] Implemented under §201 of the Trade Act of 1974.
[8] This is for List 3 products in the China §301 trade practices case.
[9] See U.S. Trade Representative Request for Comments and Notice of Public Hearing: "Request for Comments Concerning Proposed Modification of Action Pursuant to Section 301: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation"; 83 FR 33068 (July 17, 2018).
[10] See United States v. Trek Leather, Inc., No 2011-1527 (Fed. Cir. 2014.

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