Risks Associated With Changing Global Landscape and Import Tariffs

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Relevance To Trade Creditors

- Impact of Tariffs and Other Trade Compliance Issues On Your Company?
- In Furtherance of "Knowing Your Customer": Impact of Tariffs and Trade Compliance on Your Customer's Financial Condition
  - Is customer exposed to U.S. tariffs?
  - Can customer pass tariff onto their customer?
  - Impact on supply chain
  - Impact on margins
  - Impact on insolvency risk

Trade Topics

1. Foreign Investment:
   - CFIUS: Applies to foreign investments and mandatory filings for 27 industries as part of a new Pilot Program
2. Imports/Customs: Applies to physical imports, both Customs issues and other Customs enforced regulatory issues
3. Export Controls: Applies to physical and digital exports, services, and sharing information in U.S. with foreign individuals
4. Sanctions and Restricted Parties: Applies to all transactions
5. Trade Actions: Applies to transactions affected by administration targeted actions
6. Anticorruption: Applies to all businesses selling outside of the United States

WHY ARE YOU HERE?

- Buyers, sellers, and investors need to ask questions related to trade compliance issues because:
  - Companies buy or sell liability and risk
  - Companies may have violations to report
  - Companies have regulatory compliance obligations
  - Banks care about compliance
  - Tariffs cut profits
  - Tariffs can increase risk
  - May impact supply chains
  - Strict liability for companies
  - Civil and criminal enforcement
  - Mitigating and aggravating factors matter

CFIUS

What is the Committee on Foreign Investment in the U.S? (CFIUS)

U.S. DEPARTMENT OF THE TREASURY

- CFIUS is a U.S. federal interagency committee, chaired by the Secretary of the Treasury.
- Reviews and approves foreign direct investment into the U.S.
- Investment is restricted if it impairs national security.
- Definition of "national security" has been changed to include emerging and critical technologies, critical infrastructure, and privacy data.
- Some changes mirror prior practice.
- Others are brand new and not yet in the regulations.
- Penalties for non-compliance can be as high as the value of the deal.

When is a filing mandatory?

If deal involves production, design, testing, manufacturing, fabrication or development of Critical Technology used in connection with one of the 27 pilot program industries, and foreign person will have:

- Control; or
- Access to any Material Nonpublic Technical Information; or
- Board rights; or
- Involvement in decision-making regarding the use, development, acquisition, or release of Critical Technology

What is Critical Technology?

Critical Technology is defined as:

- Defense articles and services;
- Certain items on the Commerce Control List;
- Any nuclear materials, parts, software, facilities, and equipment;
- Select agents and toxins; and
- Emerging and foundational technologies.

What are Emerging Technologies

- The new rule on emerging technologies adds five categories to the Commerce Control List: <u>discrete microwave transistors, continuity of operation software, post-quantum cryptography, underwater transducers, and air-launch platforms</u>
- These categories were added as part of the Department of Commerce efforts to regulate technologies that could impact national security
- More technologies are expected to be added in the coming months:
  - AI
  - Biotechnology
  - Microprocessor technology
  - Additive manufacturing
  - Advanced materials
  - Advanced surveillance
  - Robotics
  - Logistics tech

When is a filing voluntary?

- Any deal that could result in Control of a U.S. business by a foreign person; or
- Any change in a foreign person's rights with respect to a U.S. business in which the foreign person has an investment that could result in foreign Control of the U.S. business; or
- Any other transaction designed to evade or circumvent CFIUS review; or
- Some Real Estate Investments; or
- Some Non-Controlling Investments in Critical Infrastructure and Sensitive Personal Data.

NOTE: NO DE MINIMIS EXCEPTION

Mandatory Pilot Program Process

- Obtain written determination from counsel regarding need for mandatory declaration
- Mandatory declarations must be filed at least 45 days prior to a transaction’s expected completion date (Committee has 30 days to take action)
- Parties may choose to file a voluntary notice under CFIUS’s standard procedures rather than a mandatory declaration
- Parties that are required to file with CFIUS and do not do so can be assessed a civil monetary penalty up to the value of the transaction

Voluntary CFIUS Process

- Obtain written determination from counsel regarding need for voluntary notice
- Submit voluntary notice to CFIUS (up to 45 days of review by Committee)
- CFIUS may initiate a subsequent investigation (must be completed in 45 days)
- CFIUS may refer the deal to the President for a decision (must issue a decision within 15 days)
- This process is more policy focused and weighs all the factors
- Fee to file

Imports/Customs

What Are the Import/Customs Risks?

- Regulatory Violations - safety, environmental, FDA, UL, etc.
- Seizures
  - IP violations
  - Mislabeled goods
- NAFTA requirements
- Unpaid/Underpaid Tariffs
  - Incorrect value
  - Wrong country of origin
  - Wrong classification
  - Antidumping/countervailing duties
  - Trump duties

Importers Always Have a Duty to Exercise Reasonable Care!

Section 301 Tariffs

- The Section 301 investigation found that:
  - China uses joint venture requirements, foreign investment restrictions, and administrative processes to obtain technology from U.S. companies;
  - China deprives U.S. companies of the ability to set market-based terms in technology-related negotiations;
  - China directs and unfairly facilitates the systematic investment in, and acquisition of, U.S. companies and assets to generate large-scale technology, transfer; and
  - China conducts and supports cyber intrusions into U.S. commercial computer networks to gain unauthorized access to commercially valuable business information
- **Trump administration imposed 4 tranches of tariffs. Tranches 1-3 are imposed at 25%.**

Section 301 Tariffs

- **LIST 4:**
  - A 15% tariff will be imposed on the remaining $300 billion of goods of Chinese-origin goods imported into the U.S., in two tranches:
  - **List 4A** – 15% tariff on list of HTS subheadings became effective on 1 September 2019
  - **List 4B** – 15 % tariff on list of HTS subheadings will become effective on 15 December 2019
    - Cell phones, laptop computers, video game consoles, certain toys, computer monitors, and certain items of footwear and clothing
  - Exclusion process may be established, but details have yet to be released

Section 301 Tariffs

- **Recent Developments:**
  - Talks between the U.S. and China have restarted, the administration has cancelled some planned tariff hikes, and both sides have signaled that a deal is in the works (but nothing is in writing yet)
- **Exclusion Key Questions:**
  - Whether the product is available only from China
  - Whether the tariff will cause sever economic harm to U.S. interests
  - Whether product is strategically important to Chinese industrial programs
  - Requestor gross revenue
  - Alternative sourcing considerations
  - Product function, application, and principal use

NAFTA & USMCA

- Major changes include:
  - A new digital trade chapter that continues the ban on customs duties on digital products and requires anti-spam laws
  - Increases North American automobile manufacturing requirements to have more locally produced items
  - Increases U.S. access to Canadian dairy markets
- Status of approval:
  - Mexico has fully ratified as of June 2019
  - Canada ratification in tandem with U.S.
- U.S. needs to ratify:
  - President Trump has called on Congress for ratification
  - Democrats in Congress have outstanding concerns with the text of the agreement

Contracting Around Tariffs

- Suggested Contract Provision
  - "In the event Seller's cost for goods is increased by new taxes on the import or export of goods imposed by a domestic or foreign government (a "Tariff"), Seller is permitted to temporarily increase the sales price of the goods by the amount actually paid by Seller directly or indirectly to pay or otherwise satisfy the Tariff."

Including Tariff As Surcharge or Price Increase Without Contractual Support

- Leverage Over Customer
- Industry Issues
- What are Competitors Doing?
- Deduction/Chargeback Risk

Exports

Why does the U.S. Government regulate exports?

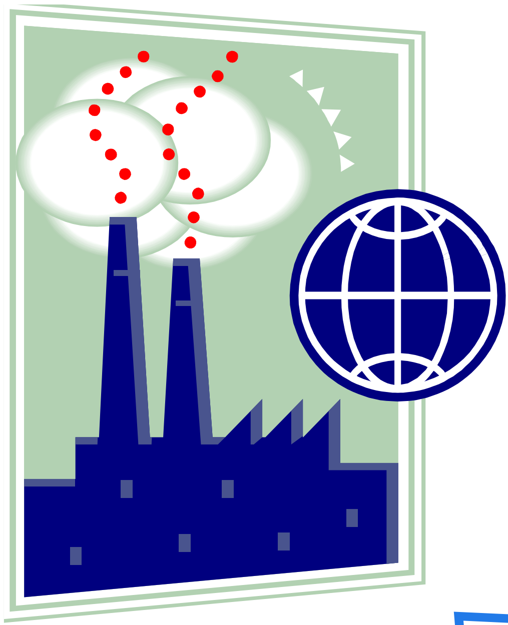
U.S. Agencies That Regulate Exports

U.S .Department of State, Directorate of Defense Trade Controls (DDTC)
Governs defense articles and services and technical data, including space and satellite related articles

U.S. Department of Commerce, Bureau of Industry and Security (BIS)
Governs commercial and dual-use items and technology, including software and encryption items

U.S. Department of Treasury, Office of Foreign Assets Control (OFAC)
Implements the primary sanctions regime and imposes economic and trade sanctions on designated countries, entities, and persons

What is an Export?



- Send or Carry items/information out of the country
- Re-Export items/information from the original country of export to a third country
- Provide Defense Services outside of the country; and
- "Deemed Exports"
- Brokering

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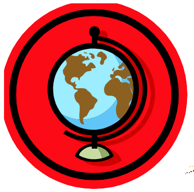
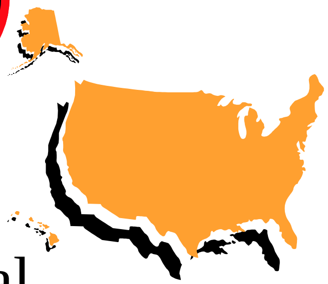
What is a “Deemed Export”?





- The actual release or transfer of technology or technical data to a foreign person **<u>IN</u>** the United States

- It is **<u>NOT</u>** required for the data or technology to be exported outside of the U.S.

Releasing controlled technology to a foreign person is DEEMED to be an export to the person’s country or countries of nationality.

What are Technology and Technical Data?

TECHNOLOGY

- Specific information necessary for the "development, production, or use" of a product. "Use" = information allowing a person to do all six of the following:
  1. Operate
  2. Install
  3. Maintain
  4. Repair
  5. Overhaul
  6. Refurbish an item

TECHNICAL DATA

- Information "directly related" to Defense Articles, including:
  - Information required for the design, development, production, manufacture, assembly, operation, repair, testing, maintenance or modification of a Defense Article
  - Classified information related to Defense Article or Services AND "600 series" items now delineated on the CCL and Information covered by an invention secrecy order
  - Software directly related to Defense Articles
- Public Domain exclusions apply

Export Law Basics- Who is a Foreign Person

- **Any Person who is not:**
  - A U.S. Citizen
  - A U.S. Lawful Permanent Resident
  - A Person Granted Asylum
  - A Refugee
  - A Temporary Resident Granted Amnesty

Sanctions

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Department of Treasury

Office of Foreign Assets Control (OFAC)

- OFAC administers a series of laws that impose economic sanctions against hostile targets to further U.S. foreign policy and national security objectives. These targets include:
  - foreign governments (i.e., Iran, Sudan, and Cuba),
  - individuals (i.e., terrorists and narcotics traffickers),
  - groups (i.e., drug front companies and charities linked to terrorist groups), and
  - practices (i.e., cyber crimes, trade in non-certified rough diamonds and proliferation of weapons of mass destruction)

OFAC Sanctioned & Embargoed Countries

- Balkans
- Belarus
- Burma
- Burundi
- Central African Rep.
- Cote d'Ivoire
- Crimea
- Cuba
- Democratic Republic of the Congo
- Iran
- Iraq
- Lebanon
- Libya
- North Korea
- Nicaragua
- Pakistan
- Russia
- Somalia
- Sudan
- South Sudan
- Syria
- Ukraine
- Venezuela
- Yemen
- Zimbabwe

* OFAC sanction programs are in constant flux; countries may be added or removed at any time.

Specific Country Sanctions Programs

- Crimea
  - Prohibitions against new investment, in imports from, and exports to Crimea
- Russia
  - Sectoral sanctions prohibit doing business with entities on OFAC's "SSI List" depending on the transaction and the industry
- Iran
  - Continuation of harsh sanctions – no U.S. person can do business in or with Iran or an Iranian company without a license or exception
- North Korea
  - No U.S. person can do business in or with North Korea or a North Korean company without a license or exception

Specific Country Sanctions Programs

- Venezuela
  - New sanctions on two levels: primary and secondary, where primary sanctions prevent any U.S. person from dealings with Venezuela and secondary sanctions allow the U.S. government to block property of individuals or companies worldwide who assist, sponsor or support the Venezuelan government.
  - Should conduct due diligence before entering into any dealings with the Venezuelan government and keep records of those interactions.
  - Sanctions on Venezuelan oil sector as of January 2019
- Cuba
  - Generally cannot do business in Cuba without a license or exception
  - People-to-people educational exception has been eliminated

Secondary Sanctions

- Non-U.S. companies must understand U.S. sanctions and how the sanctions affects their businesses
- OFAC secondary sanctions are designed to influence the actions of non-U.S. parties to prevent them from doing business with sanctioned entities and countries- like Iran and N. Korea
- The sanctions put pressure on other countries to align with U.S. policies
- If non-U.S. Parties do not comply with U.S. sanctions, the non-U.S. parties risk being listed on a sanctions list themselves and this risks access to the U.S. market and/or financial system
- Most companies are choosing the U.S. financial system over doing business in sanctioned places

How to Review a Company's Compliance?

- Does the company review import classifications and look for alternative sources in other countries?
- Has it looked at changes in supply chain to take advantage of trade agreements?
- Does it provide training and compliance materials to avoid violations?
- Does it educate and provide checklists to avoid export and sanctions violations?
- Review agreement language
- Impose trade obligation on other parties in transactions – SHARE THE RISK!
- Know your customer, and
- Complete thorough due diligence

Impact of Tariffs and Trade Issues on Customer's Financial Condition

Risk of Tariffs On Your Customers

- Knowing Your Customer Includes Understanding Tariff and Other Trade Compliance Risks
- U.S. and China Tariff Increases Have Hindered Both U.S.' and China's Economies and the Global Economy
  - Other trade disputes have contributed to global slowdown
  - World trade down for first half of 2019 and expected to drop for entire year
- Adverse Impact on U.S. Business Confidence
  - In 3d Quarter 2019, U.S. manufacturing sector reported to have contracted for first time in 3 years

Impact of Tariffs on Certain Industries

- New Tariffs Could Impact 100% of the Toys and Sports Equipment Imported from China, as well as 93% of the Footwear and 91% of the Textiles and Clothing [Peterson Institute for International Economics]
- Almost All Retailers Are Now Feeling the Pinch from Tariffs Across Their Product Lines

Impact of Tariffs on Certain Industries

- Metals Industry Impacted By Tariffs
  - Positive for some companies:
    - Higher tariffs have encouraged changed sourcing from foreign suppliers to domestic steel mills
  - Negative for other companies that import from China and other countries affected by tariffs

Risk of China Tariffs on Troubled Retailers

- Margins Squeezed Where Retailer Cannot Increase Prices Sufficiently to Cover Full Impact of Tariff
- Competitors Not Subject to Tariff Do Not Need to Raise Prices, Further Pressuring Troubled Retailer
- Supply Chain Risk – Inability to Source Goods From Different Countries Not Subject to Tariff
- Increased Bankruptcy Risk

Retail Supply Chain Issues

- Where Companies Source Their Products Determines How They Would Fare When Tariffs Hit
- Retailers and Brands Have Been Shifting Their Sourcing Away From China
- Nevertheless, China Remains Dominant Supplier Accounting for 49% of Total Textile and Apparel Imports to U.S. by Quantity in 2018 (United States Fashion Industry Association – 3/2019 report, Retail Dive)

Cost of Shifting Supply Chains

- Shifting Supply Chains Is Not Easy and Comes With Significant Cost
  - Could take a year or more to move to other countries
  - Quality risk if rushed
  - Capacity constraints
    - Very difficult to replicate elsewhere China’s well-developed and integrated technology supply chain
- Rushed Imports to Avoid New Tariffs Raise Risks
  - Consumers fickle/product may not sell

China Retaliatory Tariffs

- Restoration of Previously Suspended Tariffs on American Vehicles and Auto Parts
- Tariffs on Other U.S. Goods
  - Crude oil
  - Electronic devices, machinery and household appliances
  - Agricultural goods
    - Soybeans
    - Wheat
    - Cotton
    - Other agricultural products
    - Some recent relief

Tariffs and Other Trade Related Claims – Impact on Customer in Bankruptcy

- Claims Are “Tax” and May Enjoy Priority Status
- Reduces Recovery on General Unsecured Claims

Questions?

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Andrew counsels domestic and foreign clients on a broad array of trade issues, including import and export controls, economic sanctions on foreign countries (including Iran, Cuba, North Korea, and Russia/Crimea), secondary sanctions on third-country entities, anti-boycott compliance, anti-bribery and Foreign Corrupt Practices Act (FCPA) compliance, Committee on Foreign Investment in the U.S. (CFIUS) and Foreign Investment Risk Review Modernization Act (FIRRMA) reviews and filings, U.S. Customs and Border Protection (CBP) seizures and disclosures, USCIS Form I-129 Part 6 certifications, and sanctions issues pertaining to EB-5 and E-2 immigration matters. He regularly advises clients on the risks associated with cross-border M&A and investment transactions and on the trade compliance requirements and policy considerations pertaining to the transfer of controlled information, technology, software, defense articles and services, and commercial goods.

In addition, Andrew works diligently with clients to properly classify items and make country-of-origin determinations for import and export purposes, as well as to acquire licenses from and navigate the disclosure processes of the Department of Commerce's Bureau of Industry and Security (BIS), the Department of State's Directorate of Defense Trade Controls (DDTC), and the Department of the Treasury's Office of Foreign Assets Controls (OFAC). He also helps businesses remain compliant with U.S. trade regulations through the design and implementation of comprehensive, company-specific compliance programs, manuals, and trainings focused on the International Traffic in Arms Regulations, the Export Administration Regulations (EAR), the Foreign Corrupt Practices Act (FCPA), U.S. embargoes and sanctions, and U.S. import and labeling requirements.

Prior to joining the firm, Andrew worked as a trade analyst and then as an associate attorney on the Global Business team of an AmLaw 100 firm in Washington, D.C. He also spent a semester at the Chinese University of Hong Kong, where he studied Hong Kong and PRC transactional law. Andrew is fluent in Greek.

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Among his various legal recognitions, Bruce received the Top Hat Award in 2011, a prestigious annual award honoring extraordinary executives and professionals in the credit industry. He was co-chair of the Avoiding Powers Committee that worked with the American Bankruptcy Institute’s Commission to Study the Reform of Chapter 11 and also participated in ABI's Great Debates at their 2010 Annual Spring Meeting, arguing against repeal of the special BAPCPA protections for goods providers and commercial lessors, and was a panelist for a session sponsored by the American Bankruptcy Institute. He is a frequent presenter at industry conferences throughout the country, as well as a prolific author regarding bankruptcy and creditors’ rights topics in various legal and trade publications.

Education

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