

HAYNES BOONE

COVID-19

Supply Chain Issues in the U.S., China
and the UK - How to Navigate Contractual
Obligations and Avoid Disputes

WEBINAR

January 11, 2022

Panelists:

Gilbert D. Porter Partner, Chair- COVID-19 Task Force, New York

Liza Mark Partner, Chief Representative and Administrative Partner, Shanghai

William Cecil, Managing Partner and Head of the Dispute Resolution Team, London



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Supply Chain Challenges: China/ U.S./U.K. Perspectives

Introduction

January 11, 2022

**Gilbert D. Porter, Partner,
Chair- COVID-19 Task Force, New York**

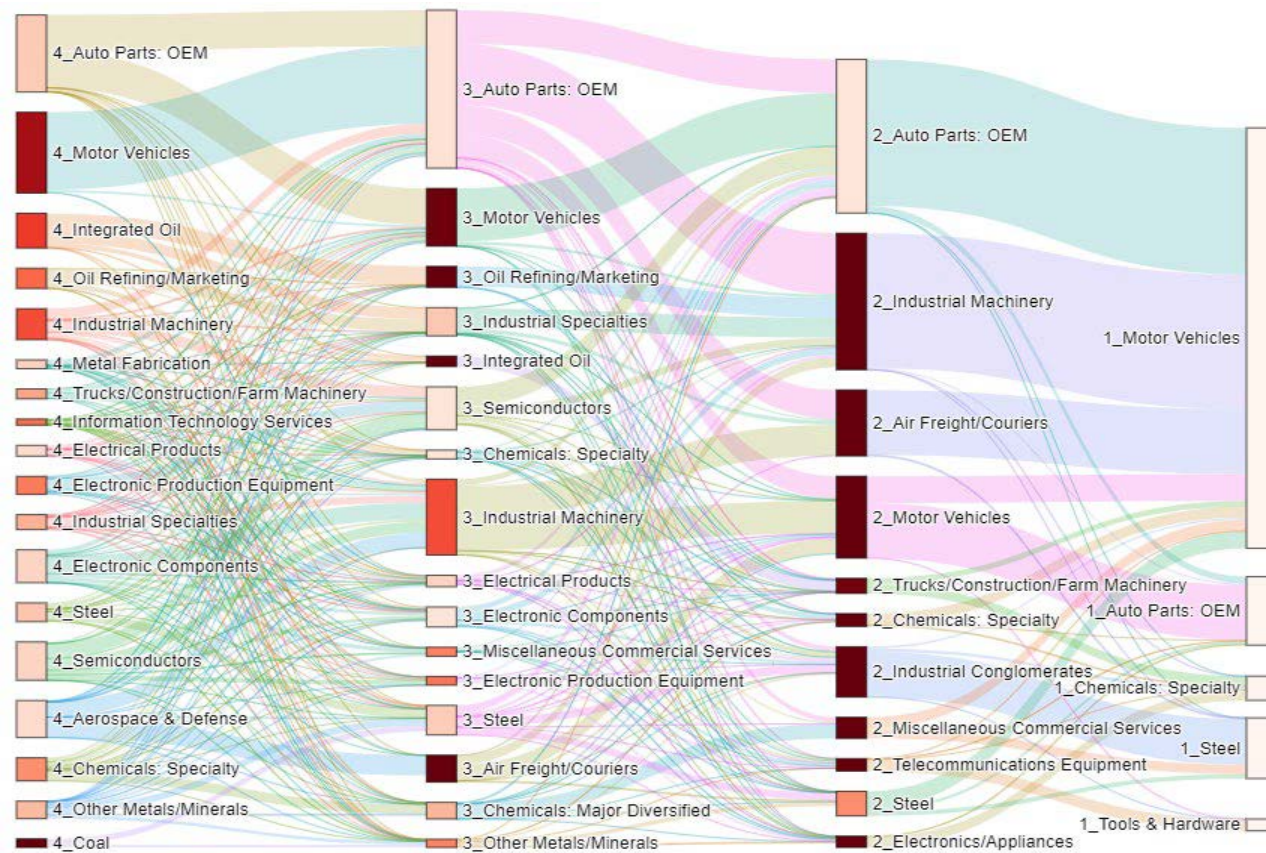


Unprecedented Disruption of Supply Chain

- U.S. port delays of 4+ weeks
- Container ports in the UK turning away shipments due to backlog of containers
- Sporadic COVID outbreaks in China affecting manufacturing and shipping
- Spiraling shipping costs as delivery times become increasingly uncertain
- Ongoing challenges of local deliveries after import
- Inflationary price pressures

Complex Supply Chain Logistics

Decades of just-in-time “lean” manufacturing creates an increasingly complex supply chain



Complex Factors

- Manufacturing suspension/delays due to COVID shut-downs
- Labor shortages from COVID and beyond
- Unprecedented global impact of COVID
- Unprecedented cyclical duration COVID impacts
- Shutdowns and government policies increase consumer available funds
- Shift of consumer spending from services to goods
- Implicit design of most supply chains to manage demand cut-backs more efficiently than demand increases
- Ease of internet shopping during isolation
- Limited additional capacity at existing port facilities to take up slack from disruptions
- Trailing challenges in local delivery (trucking)
- Organic nature of supply chain logistics defies unified solutions
- Mixed incentives

SPEAKERS AND TOPICS

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“Current Trends and Future Expectations Regarding U.S.- China Tariffs and Supply Chains.”



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“Contracting Strategies: English Law Perspective.”



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“U.S. Legal Perspective and Some Contract Terms to Remember.”

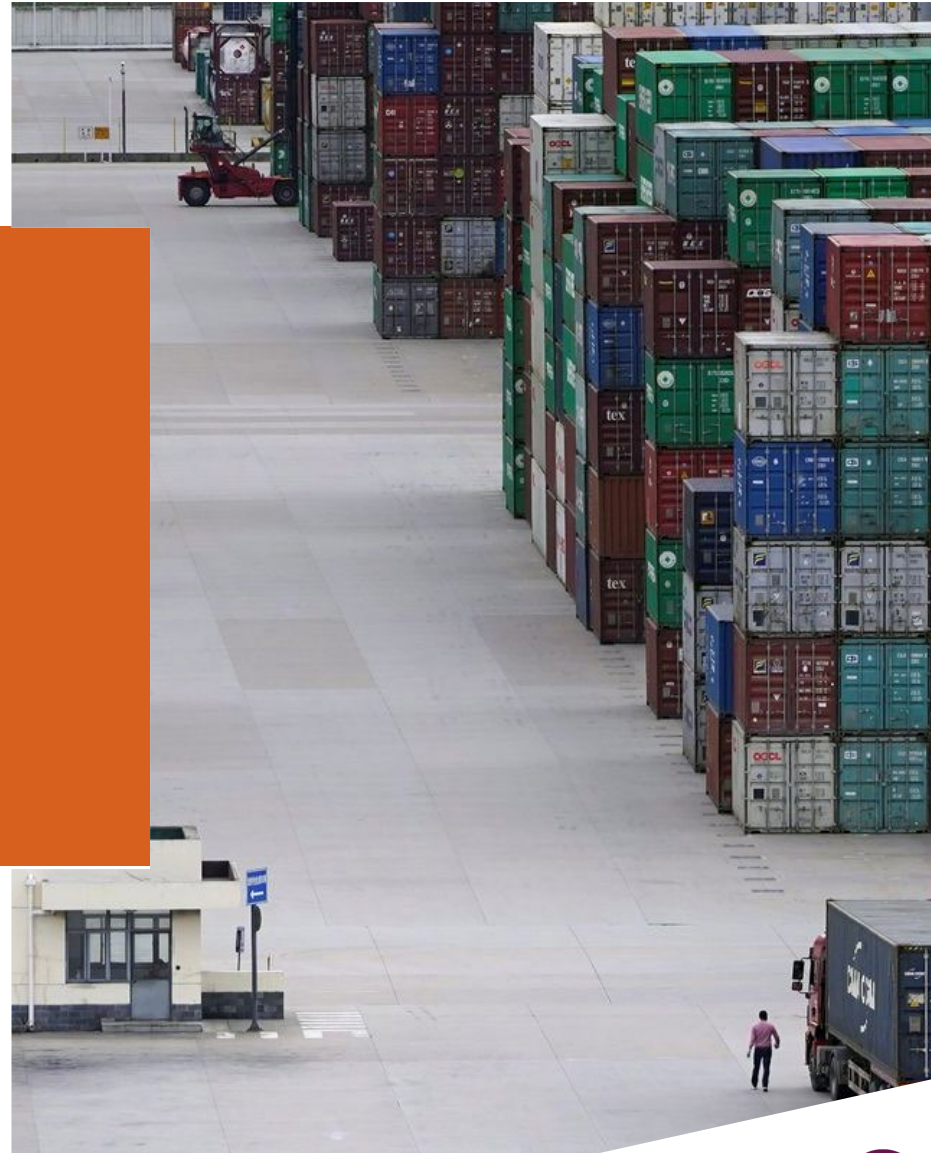


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Current Trends and Future Expectations Regarding U.S.– China Tariffs and Supply Chains

11 January 2021

**Liza Mark, Partner, Chief Representative
and Administrative Partner, Shanghai**



Biden has Amplified Anti-China Alliance

- Biden now characterizes the U.S.-China conflict as “a battle between the utility of democracies in the twenty-first century and autocracies.”
- Over the past few years, both US and China have adopted a series of rules and regulations that affect cross-border investments and cross-border commerce.

U.S.	China
<p>Trade War – Phase 1 Trade Deal</p> <p>US significantly tightened its export controls regulations, often specifically targeting China and Chinese companies such as Huawei.</p> <p>Chinese investments in U.S. is facing the highest regulatory scrutiny in a long time, especially in the areas of sensitive personal data, critical infrastructure and critical technology.</p> <p>Geo-Political Tensions – Hong Kong, Taiwan & Xinjiang.</p>	<p>Trade War – Phase 1 Trade Deal</p> <p>China adopted the Foreign Investment Law – which aims to encourage foreign investment.</p> <p>Regulatory burdens of foreign investors are still high, such as cybersecurity law, data protection law, personal information protection law, national security law.</p> <p>Geo-Political Tensions – Hong Kong, Taiwan & Xinjiang.</p>

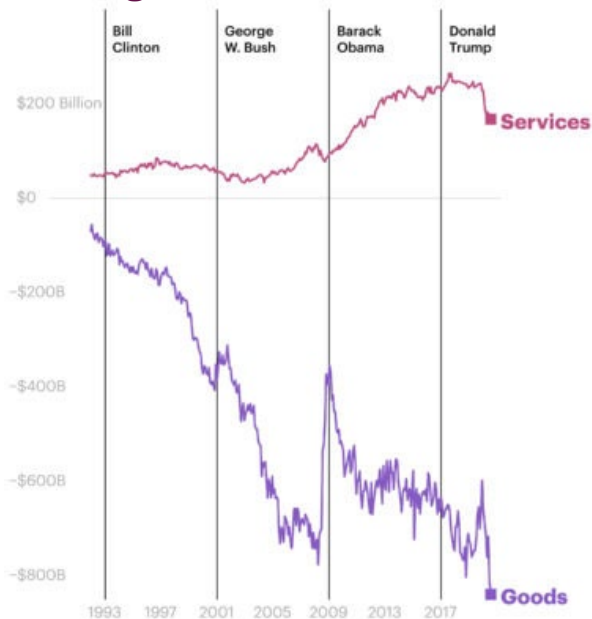
Recent Developments of Biden Era US–China Tensions

- On October 26, 2021, China’s Vice Premier **Liu He** and US Treasury Secretary **Janet Yellen** talked via video call and **discussed the economic situation and bilateral relations**. The two sides agreed that developments in China and the US have important implications for the global economy and it’s crucial for both countries to strengthen communication and coordination of macroeconomic policies
- On November 15, 2021, US President **Joe Biden** and Chinese President **Xi Jinping** had their **first virtual meeting** on Monday evening US time (Tuesday morning China time), which lasted more than three and a half hours. They discussed a wide range of issues, including their complex bilateral relations, their stances on Taiwan, and views on health security, climate crisis, global energy supplies, and key regional challenges in North Korea, Afghanistan, and Iran.
- On December 2, 2021, the SEC adopted amendments to finalize the rule implementing the submission and disclosure requirements in the Holding Foreign Companies Accountable Act (HFCAA), which allows the SEC to **ban a foreign company from trading and delist the company from an exchange** if the US Public Company Accounting Oversight Board (PCAOB) is not able to audit its requested reports for three consecutive years.
- On December 6, 2021, the Biden administration will not send any diplomatic or official representatives to **Beijing 22 Winter Olympics and Paralympic Games**, citing **human rights concerns**. US athletes will still be allowed to participate.
- On December 23, 2021, the Biden administration signed into law the **Uyghur Forced Labor Prevention Act** to ban all imports from China’s Xinjiang region over concerns about alleged forced labor.

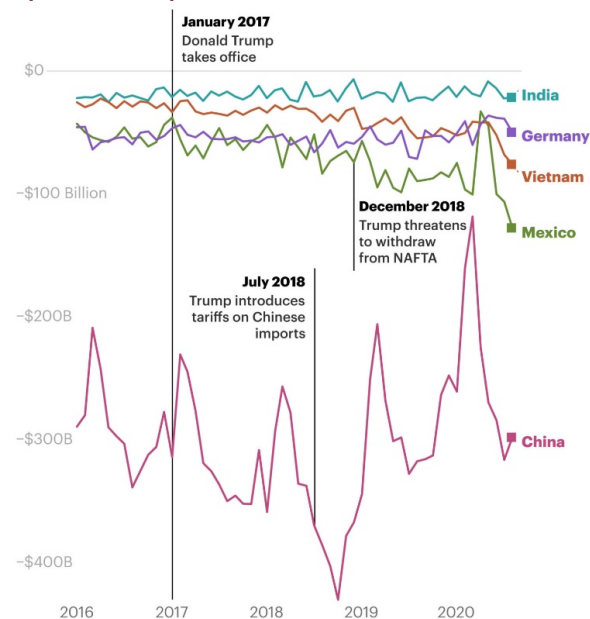
U.S. is not “Winning” the Trade War

- Data shows U.S. has not achieved the intended results on “winning over” China in either goods or services by reducing trade deficits with China. The U.S. trade deficit with China rose 20% in the last 12 months (as of 3Q2021, according to the U.S. Census Bureau), despite the tariffs imposed by successive administrations.

The trade deficit in goods has continued to mount, while the surplus in services has begun to fade:



While the U.S. has been buying less from China, other countries have picked up the slack:



US-China phase one tracker: China's purchases of US goods

- Through October 2021, China's total imports of covered products from the US were \$208.3 billion, compared with a year-to-date target of \$334.8 billion. Over the same period, US exports to China of covered products were \$186.2 billion, compared with a year-to-date target of \$310.8 billion.
- Through October 2021, China's purchases of all covered products reached 62% (Chinese imports) or 60% (US exports) of the year-to-date target – unlikely to meet the phase-one deal commitment which has a deadline of December 31, 2021.

US exports and China's imports of all goods covered by the phase one deal, January 2020 through October 2021

a. US exports and China's imports of all covered goods, billions USD



Decoupling from China? Not really

Total monthly value of U.S. trade in goods (export and import) with China

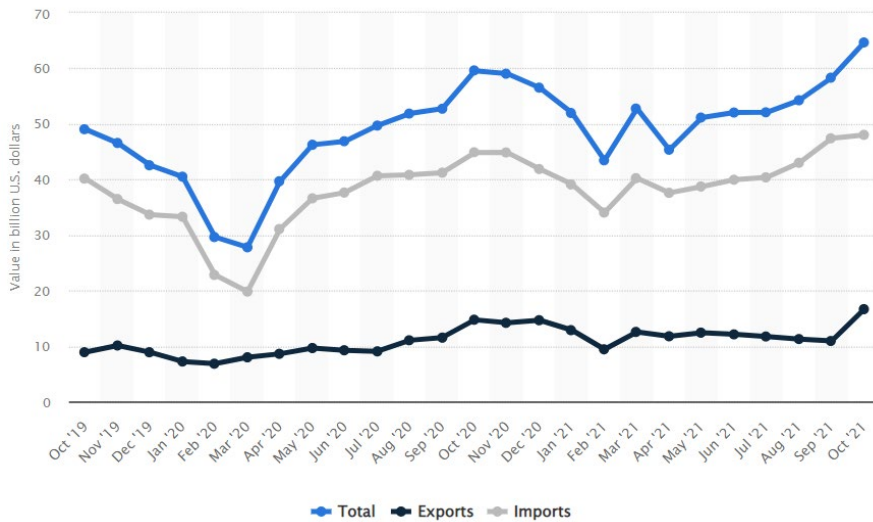
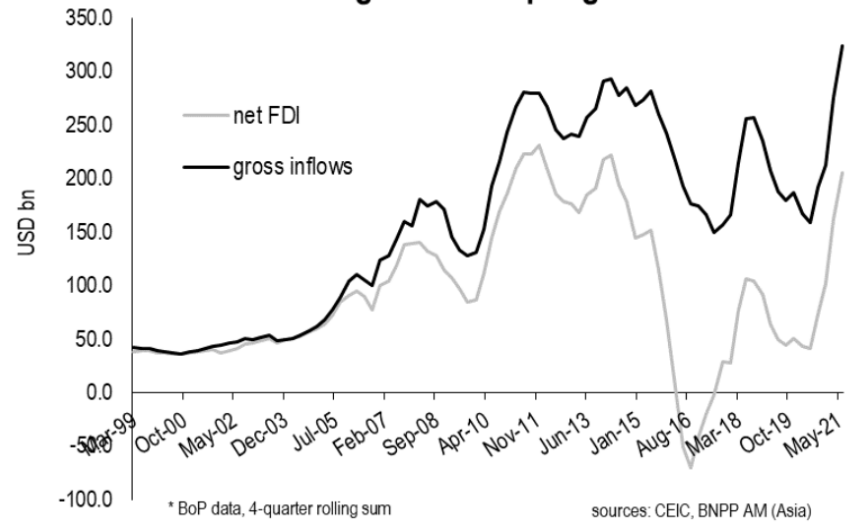


Exhibit 2: FDI flows to China* continue unabated - no sign of decoupling



Supply Chain Paradigm between US and China – Multi-Nationals not Leaving China

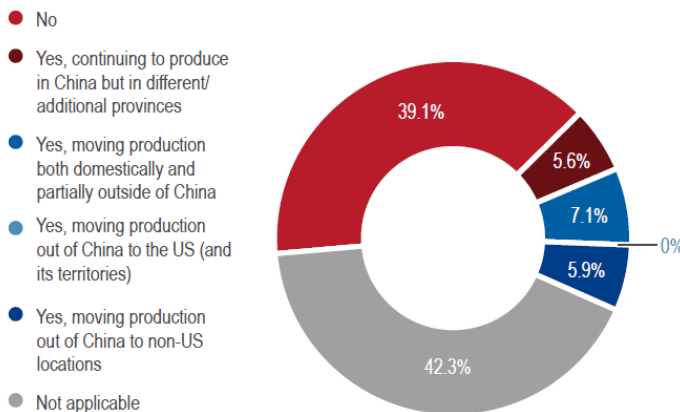
❖ Manufacturing in China for sale in China (“**In China, for China**”) strategy has been an important component of the supply chain strategy of US companies in China.

- According to a survey conducted by AmCham China, AmCham Shanghai, and PwC China (“**AmCham Survey**”), targeting senior executives from 70 large US companies in China, **87% of the respondents manufacture in China for sale in China**, among which 17% is exclusive for sales in China. Only 13% of the respondents source or manufacture export products in China.
- Key considerations behind manufacturing/sourcing “in China for China”:
 - Increasing China market demand and stable profitability
 - Higher manufacturing efficiency in China
 - Better logistics services in China

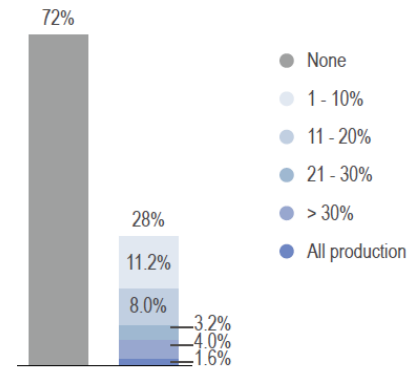
Supply Chain Paradigm between US and China – Multi-Nationals Not Leaving

- In an **annual survey conducted in 2021** by the American Chamber of Commerce in Shanghai (“**AmCham**”), no businesses were relocating their production from China to the US.
- Of companies that reported having production facilities in China, 10.3% were moving some or all of production from China to non-US locations.
- Two thirds of companies (67.7%) will keep their production where it is today. Among the 110 companies with an “in China, for China” strategy that responded to the question, 9.1% will relocate some production to other regions in China.

Fig. 25: Do you plan to move some or all of your production to other regions of China or outside China?



If your company manufactures in China, what percentage of production will you move out of China over the next three years?



* Among 125 companies

Supply Chain Paradigm Between US and China

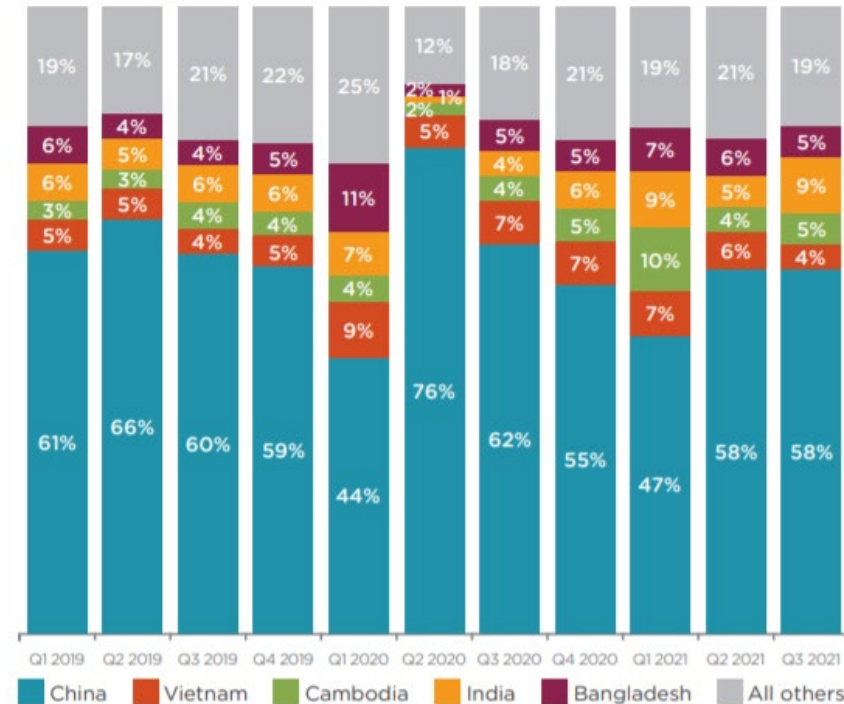
- Historically, China has been seen as a manufacturing hub. However, due to the ongoing escalation of tensions between US and China, the trade war and pandemic supply chain fragility, global supply chains are moving from a “**just in time**” structure to a “**just in case structure**”. We are seeing more of a **regionalized paradigm** and **China + 1** strategies.
- While a reshaping of global supply chains was already happening before the onset of Covid-19 - due to advances in automation, rising protectionism, and increasing frequency of natural disasters - the pandemic and worsening US-China tensions have accelerated this transformation.
- However, the tariffs are not doing as much as policymakers seem to think in forcing MNCs to choose between the United States and China, nor have they produced the desired macroeconomic outcomes.



Development Trends in Supply Chain Paradigm between US and China

- U.S firms' interests in China sourcing is renewed, but keeps diversifying:
 - China sourcing exceeds pre-pandemic levels. Demand for China inspections and audits expanding +34% year-on-year in Q2 2021 (which translates to +21% growth compared to Q2 2019).
 - China's relative share in the sourcing portfolios of US and European brands remains lower than in 2019, suggesting that even given a renewed interest in China, brands continue to diversify their buying between other high-priority geographies.
- Sourcing Diversification Accelerated by the Pandemic
 - As sourcing in multiple sectors continues rebounding from the pandemic slump, many sourcing markets of Southeast Asia are benefiting from increased buyer interest, with Vietnam, Cambodia, Indonesia and Thailand all recording double-digit growth in inspection and audit demand.
 - India saw inspection and audit volumes surge +67% in Q3 2021 compared to the pre-pandemic period (and +78% QoQ). Demand was particularly strong among US-based buyers, with September demand more than doubling from 2019 levels. Meanwhile, Bangladesh also saw demand for inspections and audits expand in Q3 2021, with orders from US-based brands up +88% in August and +108% in September, compared to the corresponding month of 2019.

Fig. 3. Top 5 inspection & audit regions (US & EU buyers)



Source: QIMA's Q1 2021 Barometer: 2020 in Review – Global Trade Covid Disruption Reveals Changes in Consumption Habits and Rampant Ethical Risks, as China Sourcing Beats the Odds; QIMA's Q3 2021 Barometer; QIMA's Q4 2021 Barometer.

Development Trends in Supply Chain Paradigm between US and China (cont'd)

- The trend is NOT new:** According to Kearney's 2019 and 2020 Reshoring Index Reports, the shift of U.S. manufacturing imports from China to other Asian low-cost countries has been going on for more than 5 years and was accelerated in 2019 by the U.S.- China trade war. In 2020, China's early re-emergence from COVID, while many other countries were still shut down, created a spike in exports to the US, as American companies found more reliable sources of supply from China than from domestic producers. Yet by the end of 2020, China was back to gradually losing share to its fellow Asian exporters.



China's Supply Chain Fragility

- Contractual Considerations – Frustration and Force Majeure
 - ***Situation on the Ground - Unpredictable Restrictive Lockdown Measures***
 - COVID-19 is no longer an unforeseen incident. However, the various Chinese governmental pandemic mitigation and prevention measures (e.g., locking down **City of Xian** in December 2021, closing of the **Ningbo Container Port** in August 2021 . . . Etc.) are still unforeseen incidents that can serve as a basis of force majeure claims.
 - At the **beginning of 2022**, supply chains running through the **Ningbo Container Port** are facing renewed delays in the wake of a Covid cluster. Truck entry is restricted into the port due to lockdown measures in the Beilun District, where cases were found on Jan. 1, though no cases have been found in the port itself. Only 6,000 out of more than 20,000 available truck drivers have been cleared for entry and exit from the port along five designated routes, causing delays in the weeks before the busy Lunar New Year season.

China's Supply Chain Fragility (cont'd)

▪ *Legal Developments*

- During April through June 2020, the **Supreme People's Court** issued **Guidance on Questions Relating to Properly Adjudicate COVID-related Civil Cases** (《关于依法妥善审理涉新冠肺炎疫情民事案件若干问题的指导意见(一)、(二)、(三)》), which are widely cited as the basis of handling contractual disputes due to COVID-19 disruptions.
 - According to the Guidance, Chinese courts should balance interests of all parties in adjudicating matters impacted by COVID and apply the force majeure defense and the principle of fairness. Liability will need to turn on the “**causal relationship**” between contract performance and COVID measures, etc.
 - “If the epidemic situation or the epidemic prevention and control measures **directly cause** the failure to perform the contract, the provisions of force majeure shall apply in accordance with the law, and liability shall be exempted in part or in whole based on the extent of impact of the epidemic situation or the epidemic prevention and control measures.”
 - “If the epidemic situation or the epidemic prevention and control measures only lead to difficulties in the performance of the contract, the parties concerned may re-negotiate; if continuous performance is possible, the people's court shall effectively strengthen mediation and actively guide the parties concerned to continue the performance.”
 - The Guidance also specifically offers foreign parties extension of civil procedure deadlines if impacted by COVID, such as document authentications, power of attorneys, evidence productions, etc.

China's Supply Chain Fragility (cont'd)

- ***Contract Negotiation Strategies – Best Practices***

- When commercial contracts with Chinese suppliers are adversely impacted by COVID measures, foreign businesses should:
 - **Contract negotiation stage** - be clear about each parties' obligations and events of default in light of the pandemic. If certain COVID measures are common and foreseeable, specifically exclude these from the definition of "force majeure" exemptions.
 - When default occurs by Chinese party, promptly and actively **investigate the cause** to see whether directly related to COVID measures, and if so, to what extent.
 - Always **keep proper documentation** of all correspondence. Strictly follow the "notice" provision in communicating with the defaulting contract party.
 - The China council for the Promotion of International Trade (中国贸促会) is still issuing "**force majeure certificates**" when grounds for invoking the force majeure clause arises as a result of COVID-related government measures. This may serve as reasonable evidence for the factual grounds of the exact COVID measures for claiming force majeure exemption. It is not a "free pass" that force majeure clause has been successfully invoked, nor is it Chinese government's official endorsement of such.

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Contracting Strategies: English Law Perspective

January 11, 2022

**William Cecil, Managing Partner and
Head of the Dispute Resolution Team,
London**



1. Illegality

- Origins of the doctrine: public policy, coherence
- Limitations as regards the Coronavirus pandemic
 - What was actually illegal?
- Need to consider other jurisdictions, particularly given the international nature of the supply chain

2. Frustration

- Origins of the doctrine: holding parties to *their* bargain
- Limitations as regards the Coronavirus pandemic:
 - **Burden of proof**
 - **Concurrent causes**
 - **Move from primary to secondary consequences**
 - **Election of contracts**
 - **Self induced frustration**
 - **Where obligations are merely more onerous**
 - **Contract provides for the event**

3. Force Majeure

- **Origins of the doctrine: parties defining their bargain**
- **Potentially infinitely varied**
- **Potential limitations as regards the Coronavirus pandemic:**
 - Burden of proof
 - Causation?
 - Move from primary to secondary consequences
 - Need to follow, strictly, contractual requirements
- **Analysing distinct points:**
 - “*Act of God*”
 - *Nugent v Smith (1876) 1 CPD 423* - Cockburn CJ
 - Foreseeability?
 - Self-induced?

4. Contracting Strategies

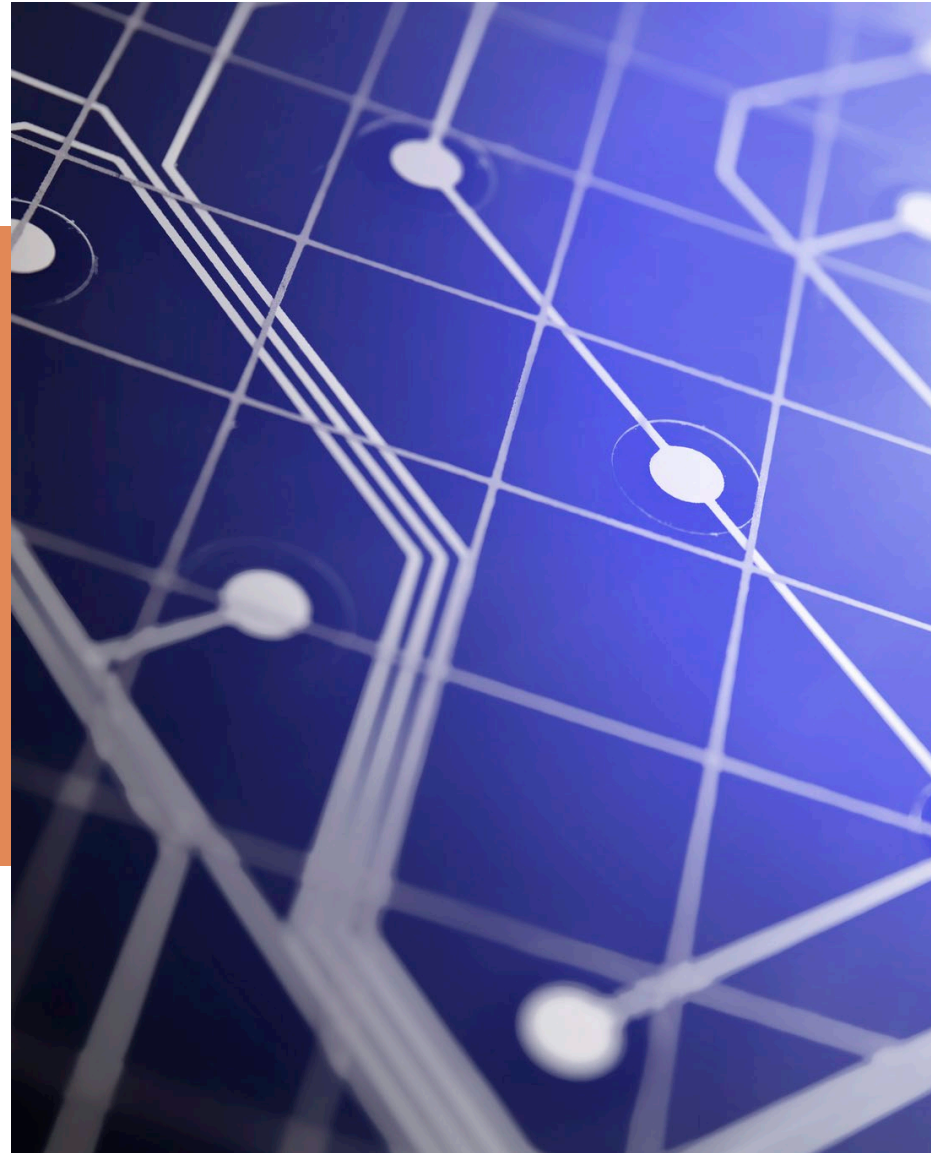
- **Try not to rely on general doctrines**
 - Illegality is of limited scope
 - Frustration is a high hurdle
 - **Define, as far as possible, force majeure clauses**
 - Who is best placed to bear risks?
 - What, exactly, will trigger the clause coming into operation?
 - Foreseeability?
 - Lists of events?
 - **Treat as a contract variation event?**
 - **Worth considering whether it is worth extending leniency/acting constructively**
 - *Dwyer (UK Franchising) Ltd v Fredbar Ltd and another [2021] EWHC 1218 (Ch)*
 - **Include a good faith obligation?**
-

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U.S. Legal Perspective and Some Contract Terms to Remember

January 11, 2022

**Gilbert D. Porter, Partner,
Chair- COVID-19 Task Force, New York**



plus ça change...

- U.S. contract legal principles *for this topic* comparable to English law
 - “illegality” and “frustration” not viable defenses for most commercial contracts
 - “force majeure” provisions enforced narrowly as (and if) drafted into the contract
 - equitable relief from contracts is limited

But ...

- Legal enforcement of supply contracts is relatively unusual in commercial settings
 - More likely used as leverage for commercial renegotiation
 - Damages may be hard to establish
 - “lost profits” typically excluded from damages
 - no “liquidated damages provisions
 - “cost of cover” only useful if replacements can be found
 - problems with enforcement of “market-price” contracts
 - Recovery of judgment may be difficult/unlikely
 - Lawsuits are no substitute for supply
- Legal enforcement more likely in capital investment/construction settings than in supply-chain context

Common Logistics Contract Terms to Remember

- UCC 2-308. Absence of Specified Place for Delivery
- FOB [*location or vessel*]
- FAS [*vessel*]
- CIF/C&F [*destination*]
- UCC 2-319(3). Failure of Buyer to Provide Necessary Instructions.
- Incoterms

Other Common Contract Terms to Remember

- Governing Law
- Jurisdiction
- Risk of Loss
- Step-In Rights
- Right of Cover
- Consequential or Liquidated Damages
- Commercial Reality



Commercial Reality

SOURCE: NASA.gov

You
Can't
Fill a
Black
Hole
with
Paper

Q & A



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About Haynes Boone

We carry with us the **progressive, entrepreneurial spirit** that has always animated our firm. We've always worked differently than other firms. We are committed to remaining forward-thinking and preparing for the dynamically changing world of business law.

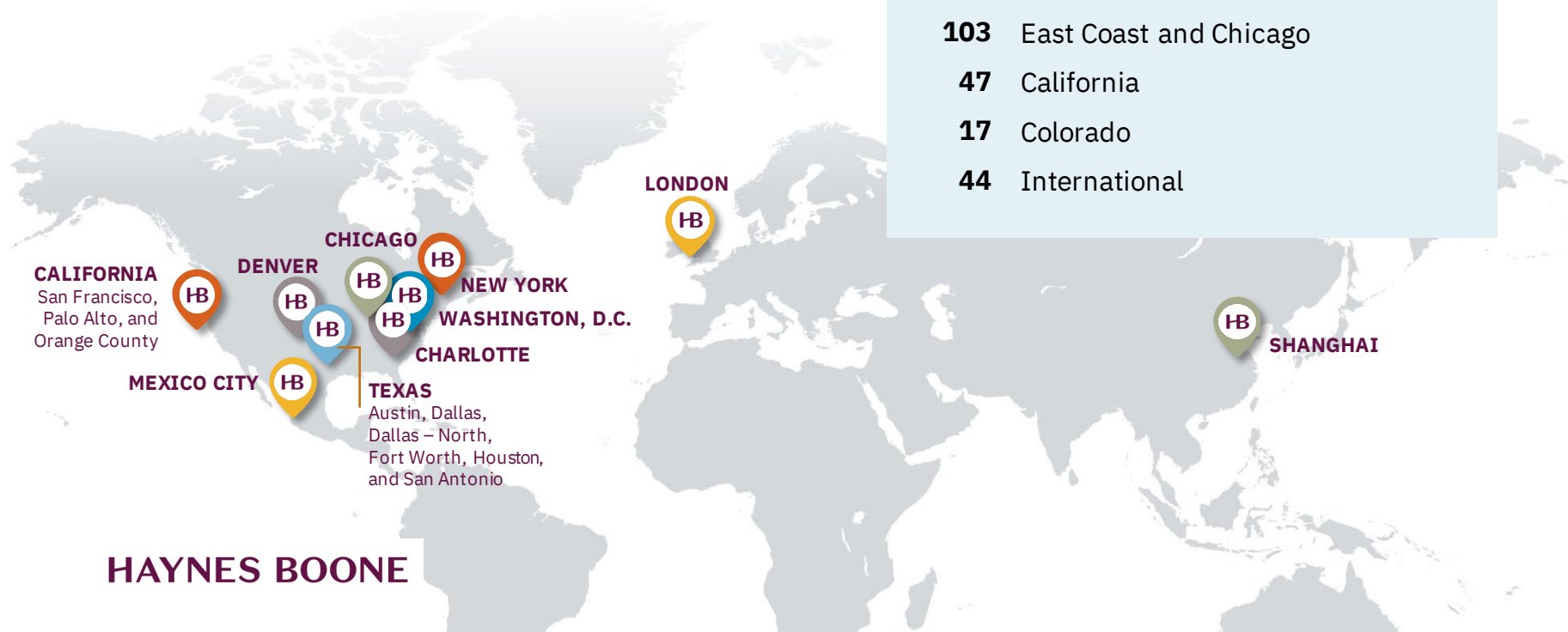
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- 199** Corporate/ Business Transactions
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