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How can retailers shore up their supply chain contracts in 2023?

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If you were a gambler, would you bet that the conflict in Ukraine will end in 2023 and that global sanctions against Russia will be removed? Or that another trade war won't spark new tariffs? Could you pick which industries have no ties whatsoever to forced labor? Or could you tell a greenwashed product apart from one that is legitimately carbon-neutral?

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If you are a retailer, chances are that you would not make those bets, at least without first hedging your exposure by tightening up trade terms in your company's supply contracts. As far as resolutions go, this is as good a time as any for a contract refresh given how volatile the supply chain has been over the last few years.

When updating their supply agreements, retailers should consider several issues which are likely to have an impact on trade in 2023.

Russia sanctions

Last year, the United States imposed sanctions and export controls on Russia and Belarus following Russia's invasion of Ukraine. These measures have created a rapidly changing business and commercial environment. Sanctions include a ban on the provision of accounting trust and corporate formation and management consulting services to Russia; sanctions on Russian media, financial, and technology sectors; additions to the Treasury Department's Specially Designated Nationals list; full blocking of the two largest banks in Russia; a ban on new investment in any sector of the Russian economy; and a revocation of Russia's Normal Trade Relations with the United States, among others.

Export controls include, but are not limited to, controls on Russia's industrial sector; amendments to "dual use" export controls; and licensing requirements on a wide array of exports to Russia, Russian companies, and separatist regions of Ukraine.

Companies doing business in Russia, with Russian companies, or in separatist regions of Ukraine must regularly monitor for changes in sanctions and export controls in the region. Retailers should review export controls and sanctions clauses in their supply agreements with respect to force majeure and obligations to obtain licenses or other approvals required for export, reexport, or transfer of covered goods.

Forced labor / UFLPA

U.S. protection of labor rights in international trade has existed for almost 100 years under Section 307 of the Tariff Act of 1930 (19 U.S.C. § 1307). While it has been dormant for most of that span, enforcement has increased significantly in the last several years. This has occurred through more Withhold and Release Orders ("WROs"), which allow Customs and Border Protection ("CBP") to detain shipments of products suspected to be made with forced labor, and through new legislation. In June 2022, the Uyghur Forced Labor Protection Act ("UFLPA") went into effect prohibiting the importation of certain goods from China made with forced labor.

The standard of proof required to overcome a UFLPA detention is higher than that under the WROs. The UFLPA established a rebuttable presumption that any goods, wares, articles, and merchandise mined, produced, or manufactured wholly or in part in the Xinjiang Uyghur Autonomous Region of China, or produced by certain entities identified, are not entitled to enter to the United States.

CBP has identified a list of high-priority sectors for enforcement which covers cotton, apparel, silica-based products (including polysilicon), tomatoes and downstream products (e.g., textiles, garments, solar cells). In identifying priority industries, CBP has relied on studies by non-governmental organizations such as U.K.'s Sheffield Hallam University which has also claimed that auto parts and PVC (polyvinyl chloride or vinyl) are being made with forced labor in Xinjiang.

While it is the importer of record that needs to provide a rebuttable presumption to CBP to have the products released, this takes time and could cause unwelcome delays for retailers. Given the complicated nature of sourcing and supply chains, it may be difficult for companies to assess fully whether their products may be seized or implicated in forced labor allegations.

Affirmative steps to identify and eliminate forced labor in supply chains may be addressed in part through affirmations and obligations incorporated into supply contract provisions. Affirmations, alone, however, are likely insufficient.

Retailers may need to establish detailed supply chain mapping, supply chain tracing, and provision of sample documentary evidence which can include:

- Confirmation that suppliers are not on the UFLPA targeted entity list;
- Complete shipping entry package of a recent importation (CBP Form 7501, invoice, bill of lading, packing list);
- Bill of materials;
- Purchase order;
- List of production steps and records (including raw materials procurement to finished products);
- Material suppliers list;
- Transportation documents between suppliers (including raw materials suppliers);
- Sourcing contracts with suppliers;
- Customs Trade Partnership Against Terrorism ("CTPAT") certification, if the importer is certified (CTPAT can provide an exception to the rebuttable presumption).

Retailers may also consider updating their vendor conduct standards/policies to include provisions prohibiting the use of forced labor and including similar language in their supply agreements.

Greenwashing and carbon-neutral claims

Increasingly, U.S. lawmakers are focusing on greenwashing, where companies make deceptive or false claims about the environmental friendliness of their products. The Federal Trade Commission ("FTC"), for example, is proposing updates to its "Green Guides," which the FTC uses to help marketers avoid making environmental marketing claims that are unfair or deceptive under Section 5 of the FTC Act (i.e., greenwashing).

Per its 10-year review cycle, the FTC will be reviewing and updating the Green Guides, which were last updated in 2012. Since then, the FTC has clarified that the Green Guides apply not only to environmental marketing claims made directly to consumers but also to environmental marketing claims made to another business, making the update relevant to a broad range of environmental marketing claims, such as "net zero," "carbon neutral," "low carbon," and "carbon negative."

Given this increased focus on greenwashing, retailers wishing to make environmental marketing claims should ensure they are able to clearly define what they mean and have the data to substantiate the claims they make. This may include actions such as contractually obligating suppliers to provide emissions-related information in order to be able to demonstrate how a product is "net zero, "carbon neutral," etc. when examined based on its full lifecycle.

One option that may help companies reduce the risk of greenwashing enforcement or litigation is the use of a third-party certifying organization to substantiate carbon-neutrality or other similar "green" marketing claims.

Tariff exposure

When it comes to tariffs or duties, it is the importer of record ("IOR") that is obligated to pay them to CBP. Thus, many retailers chose not to be an IOR. But others may have to be one either by design or necessity. Regardless, the cost of tariffs and duties is almost always passed downstream by the importer, and obviously retailers want to avoid that expense when possible. So, what have been the trigger points for tariffs, and how can retailers minimize their impact on the bottom line?

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The effects of the U.S.-China trade war, which began in 2018, are still lingering. Over $500 billion worth of goods from China remain subject to Section 301 tariffs ranging from 7.5% to 25%. Politically there is no appetite to remove these tariffs as being tough against China is one of the few things that brings Democrats and Republicans together. A court decision challenging some of these tariffs is expected in the next few months, but its outcome is almost certain to be appealed to the U.S. Court of Appeals for the Federal Circuit.

Besides the Section 301 tariffs, many products across various industries and multiple countries are also subject to antidumping ("AD") and/or countervailing duties ("CVD"). Importers have tried to stay ahead of these duties and when possible moved production to third countries. Diversifying the supply chain this way has mostly worked in lowering the risk of AD/CVD duties.

By shifting sourcing to a third country, importers were usually able to buy several years' time away from AD/CVD. But 2022 saw a notable increase in circumvention cases which apply existing AD/CVD duties on imports from third countries where only minor fabrication is taking place. Depending on the imported product and the extent of fabrication, this can significantly shorten the grace period achieved by diversifying sourcing to third countries.

One option to eliminate this risk is to buy American, or to re-shore and bring manufacturing to the United States.

Another is through tariff engineering by legally making certain changes in the product's characteristics in a third country or foreign trade zone to reduce the tariffs.

To further minimize tariff risk, retailers that are also IORs can include clauses in their supply agreements to ensure the vendor

represents the proper country of origin and accurately labels the product. Indemnification provisions are also possible, with the notable exception that IORs cannot be reimbursed for AD/CVD duties by the foreign manufacturers.

So, while, in gambling, the house always wins, in the market, retailers can improve their odds through a refresh of their supply contracts. Making sure to account for commercial and geopolitical risks to supply chains such as sanctions, forced labor, greenwashing, and tariff exposure is always a safe bet.

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