"TRUMP MAJEURE": MANAGING COMMERCIAL UNCERTAINTY IN A NEW AGE OF TARIFFS

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Customs duties—the fees levied by governments on imported goods—have always been a feature of international business and trade. Until recently, duties were a fairly routine subject. When they changed at all, they tended to decline as a result of ongoing multilateral trade negotiations. But all that has changed with the imposition of new trade tariffs by the Trump administration and with retaliatory measures imposed by China, the European Union ("EU"), and others. These changes can increase cost, risk, and uncertainty for companies trading in goods across borders or relying on international supply chains.

THE BREWING TRADE WARS

In March 2018, U.S. President Donald Trump announced that imports of steel would become subject to a 25% tariff effective March 23, 2018. Although various countries were exempted from the initial presidential proclamation, at present, only Australia, Argentina, Brazil, and South Korea are currently exempt from the basic tariff. Even these countries are subject to quotas limiting the total amount of steel imports from each country over a given period. Aluminum imports are subject to similar restrictions.

Also in March 2018, the president directed the U.S. Trade Representative, Robert Lighthizer, to take action to address unreasonable and discriminatory trade practices by China, as identified in a detailed investigative report. In June, the president announced the imposition of 25% and 10% tariffs on approximately $50 billion in Chinese imports.[1] In response, China announced its intention to impose retaliatory duties on a variety of imports from the United States.[2] The U.S. Trade Representative countered on July 10, 2018, with the announcement of 10% duties on another $200 billion in Chinese imports.[3]

Other nations have also announced retaliatory measures in response to the Trump administration's steel and aluminum tariffs. On May 16, 2018, the EU announced the imposition of an additional 25% duty a variety of U.S. imports, effective June 20, 2018.[4] On June 5, 2018, Mexico announced similar retaliatory measures.[5] On June 21, 2018, India announced heightened duties on 29 products coming from the United States, including steel, iron, and agricultural goods. The increases are scheduled to go into effect on August 4. Turkey announced similar tariff increases on June 25, 2018.[6] Also, on June 28, 2018, Canada imposed increased tariffs on imports of steel, aluminum, and other goods from the United States, with a total value of $16.6 billion, effective July 1, 2018.[7]

Exactly when the new tariffs take effect depends on their specific terms. The EU's retaliatory duties, for example, do not apply to products “for which the importers can prove that they have been exported from the United States to the Union prior to the date on which an additional duty is applied with respect to that product.”[8] The additional U.S. duties on Chinese products apply “to products that are entered for consumption, or withdrawn from a warehouse for consumption, on or after July 6, 2018.”[9] Unfortunately, the date on which a party committed to purchase goods at a stated price is immaterial to the applicable duty rate. In other words, the fact that an importer contracted to pay a certain price for goods on the assumption that they were subject to a 3% duty does not excuse the importer from paying a 25% duty if that rate is in effect when the goods are actually imported.

RESPONSIBILITY FOR DUTY PAYMENT

Responsibility for duty payment is often addressed by contract. In many cases, the applicable delivery “Incoterm”[10] will control. The Incoterm “DDP,” for example, means the seller must deliver the goods to the buyer with duties already paid.[11] Other delivery terms, such as FOB and CIF, generally require the buyer to clear goods through customs and pay the applicable duties. Whoever must pay duties must factor them into the overall cost of doing business. If, for example, a buyer must pay a 5% duty on a certain type of imported goods, the buyer must keep that in mind when negotiating price with the overseas seller. The seller who must deliver goods duty paid must also remember that duties will cut into the seller's margin. When duties run as high as 25%, they can result in a very unpleasant surprise for the party responsible for paying them.

Some existing contract terms may have the effect of shifting responsibility for duty payment. Take the case of a construction contract between and owner and contractor for a project requiring a lot of steel. The contractor may have protected itself from fluctuations in the steel market by including a cost adjustment term in the contract. If so, the owner would wind up bearing the loss if steel tariffs drove up the contractor's price of steel. But suppose the contractor instead entered into long-term contracts with overseas steel suppliers? Assuming the suppliers had not agreed to pay import duties, the contractor would be stuck paying them and might not have any recourse against its own customer. If, on the other hand, the contractor had a deal with a U.S.-based steel supplier, that supplier might be the one bearing the additional duty costs if its own supply chain extended abroad to countries subject to the new steel tariffs.

NEW CONTRACT TERMS

Trump-era tariffs represent a newly volatile form of commercial risk that must be managed by companies doing business across borders. How to manage it? Going forward, the simplest way is by treating tariff risk the same way parties address foreign exchange risk, swings in commodity prices, or changes in an interest rate: by dealing with it in the contract. The parties can certainly agree to revisit price if the applicable duty rate increases above a set percentage. For example, a contract could provide that, in the event of an increase of 5% or more in duty rate, the buyer would receive a corresponding price rebate. For longer-term contracts, prices could be subject to periodic adjustment based on changes in tariff rates. Such terms have the effect of transferring, or else sharing in some kind of mutually acceptable fashion, the risk of additional duties on goods. Most current contracts lack provisions of this nature; they should be drafted with care.

EXISTING CONTRACTS

What about existing contracts? A first step is to make sure the product in question is in fact subject to one of the new tariffs. It is a mistake to assume that any product containing steel or aluminum, or that is sourced from China, is subject to a new tariff. The new tariffs apply to hundreds of individual lines from the Harmonized Tariff Schedule of the United States ("HTSUS"). The HTSUS should be carefully reviewed, and if there is any doubt as to the classification of a specific product, professional advice should be sought. If necessary, a binding determination of the tariff classification of goods can be obtained from U.S. Customs and Border Protection.

TARIFF EXEMPTIONS

What if an import appears to fall squarely within either the ambit of the new U.S. tariffs or that of the retaliatory measures from other countries? Relief may still be available. The U.S. tariffs generally provide for exemptions in appropriate circumstances. For example, the Secretary of Commerce may grant an exemption from the increased steel tariffs "for any steel article determined not to be produced in the United States in a sufficient and reasonably available amount or of a satisfactory quality."[12] It appears the Commerce Department is receiving a large number of exemption applications and is summarily denying many of them for minor errors of form. It is a good idea to seek professional advice before applying.[13] Other nations may offer similar relief. In the EU, for instance, tariff relief is available for goods that are not produced in the EU or that are produced in insufficient quantities.[14]

Contracting parties may want to consider allocating responsibility for pursuing such exemptions in their agreement. For example, the parties might agree that, before seeking any adjustments to the price of goods, the party responsible for duty payment must exhaust all available opportunities to request an exemption or some other form of relief from an increased duty.

CONTRACT DEFENSE ISSUES

Assuming goods are subject to a country's tariff and no exemption is available, one or more of the parties to a contract may be facing unanticipated costs. It seems inevitable that parties exposed to significant duty-related losses may resort to litigation or arbitration for relief. Various contract law issues may arise. Although the laws vary by jurisdiction, in general, a party can be discharged from a legal obligation if performance of that obligation has been made "impracticable" by "an event the non-occurrence of which was a basic assumption on which the contract was made." Compliance with a new "domestic or foreign governmental regulation or order" is generally considered to qualify as such an event.[16]

As noted above, certain countries are exempt from U.S. tariffs on steel and aluminum but are nevertheless subject to quotas on overall importation over a given time frame. Once a quota has been met, it is essentially impossible to import any more of the affected product from the country in question. In that situation, one can certainly expect the party responsible for clearing the goods through U.S. Customs (usually the buyer) to argue that performance has been rendered impractical by imposition of the quota.

Impracticability may be a less plausible defense when goods can still be imported, just at a higher duty rate than the parties may have anticipated. In that situation, the party not responsible for duty payment (for example, the FOB seller) would likely argue that the other party accepted the risk of fluctuation in the applicable duty rate and cannot claim impracticability simply because higher duties added costs to the buyer's overall operations or reduced its profit margin on goods intended for resale. The buyer, on the other hand, may try to argue that the parties assumed that duty rates would remain the same when they first contracted and that the duty rate prevailing at the time was a basic assumption of their agreement.

It is possible for parties to enter into contracts for the international sale of goods without knowing that duty rates had recently increased with respect to those goods. Assuming delivery of the goods can be made, albeit at a higher duty rate, the party responsible for duty payment may also attempt to invoke various contractual defenses to performance. Under the law of most U.S. states, a contract can be voided “[w]here the mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances.”[17] Although many such mistakes are as to facts, the parties can also be mistaken about the law in existence at the time of their contract.[18]

Finally, many commercial contracts will contain a “force majeure” clause. The purpose of a force majeure clause is “to relieve a party from its contractual duties when its performance has been prevented by a force beyond its contract or when the purpose of the contract has been frustrated.”[19] Typical force majeure clauses excuse a party from performing where performance is prevented by an extraordinary event such as a hurricane or civil unrest. Some clauses include governmental actions, such as seizures or confiscations of property, in the list of exculpatory events. Some include changes in law or legislation, whereas others specifically exclude such changes.

Some reported cases have refused to treat changes in economic conditions, such as changes in commodity prices, as force majeure events.[20] However, the applicability of such clauses to government-imposed tariffs does not seem to have been tested. As the language of force majeure clauses vary extensively by contract, a party confronted with significant contract exposure due to tariff increases should carefully scrutinize any force majeure clause in its contract and consider seeking legal advice about the potential applicability of such clause to any tariff-related losses.

It remains to be seen whether the tariffs imposed by the United States and other nations will lead to a full-scale trade war in which trading nations impose one duty increase after another. Very recent indications are that the United States and Europe will pause their trade hostilities, at least temporarily, so that more amicable trade negotiations can go forward. But the situation between China and the United States remains tense. In a new age of trade standoffs, companies should carefully determine which products are actually subject to the new duties, explore the availability of exemptions, and consider whether their contract terms should be updated to take into account tariff volatility. Where appropriate, they should seek legal advice as to whether existing contractual terms provide either party with relief from unexpected customs expense. With an international platform of offices in United States, Europe, Asia, and beyond, K&L Gates is well positioned to provide that advice.

Notes:

[1] *See* 83 Fed. Reg. 28710 (June 20, 2018). Written comments to the Administration's Notice of Action were due on July 23, 2018. A public hearing took place on July 24, 2018.

[2] *See* 83 Fed. Reg. 33608-09 (July 17, 2018).

[3] *See* 83 Fed. Reg. 33608 (July 17, 2018). The public comment period for these proposed duties remains open until August 17, 2018.

[4] *See* Commission Implementing Regulation (EU) 2018/724 of 16 May 2018 on certain commercial policy measures concerning certain products originating in the United States of America, 2018 O.J. (L 122); Commission Implementing Regulation (EU) 2018/886 of 20 June 2018 on certain commercial policy measures concerning certain products originating in the United States of America, and amending Implementing Regulation (EU) 2018/724, 2018 O.J. (L 158).

[5] *See* Mexico: Additional Duties on Certain Products from the United States; Request for Consultation by the United States, WTO Doc. WT/DS560/1 (July 16, 2018).

[6] “Decision on Implementation of Additional Financial Obligations for the Import of Certain Products Originating in the United States of America,” Council of Ministers Decision No. 11973/2018, Official Gazette No. 30459, June 25, 2018.

[7] *See* “United States Surtax Order (Steel and Aluminum): SOR/2018-152,” CANADA GAZETTE, PART II, VOL. 152, NO. 14 (June 28, 2018).

[8] Commission Implementing Regulation (EU) 2018/724 at Art. 4.

[9] 83 Fed. Reg. 28710.

[10] Incoterms® are a body of widely recognized commercial terms published by the International Chamber of Commerce. See INCOTERMS® 2010 (International Chamber of Commerce 2010).

[11] INCOTERMS® 2010 at 69.

[12] 83 Fed. Reg. 11627 (March 15, 2018).

[13] Also, certain parties are obviously benefitted by tariffs and may want to contest exemption applications. Again, the new tariff regulations typically provide an opportunity to oppose a requested exemption.

[14] *See* Communication from the Commission concerning autonomous tariff suspensions and quotas (2011/C 363/02).

[15] 2 Restatement (Second) of Contracts § 261 (1981). The Restatement of Contracts generally reflects the majority view of jurisdictions in the United States, although each U.S. state applies its own contract law. Needless to say, international contracts of sale are often governed by the law of other nations or by the United Nations Convention on Contracts for the International Sale of Goods (“CISG”). Article 34 of the CISG exempts a party from its performance obligations where its failure is “due to an impediment beyond his control that he could not reasonably have been expected to take into account at the time of the conclusion of the contract and that he could not have avoided or overcome.”

[16] *Id.* at § 264. Article 2 of the Uniform Commercial Code also excuses a seller for non-performance based on “compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.” U.C.C. § 2-615.

[17] *See* 1 Restatement (Second) of Contracts § 151 (1981)
[18] Id. at § 151, cmt. b.
[19] *E.g.*, Phillips P.R. Core, Inc. v. Tradax Petroleum Ltd., 782 F.2d 314, 319 (2d. Cir. 1985).
[20] N. Ind. Pub. Serv. Co. v. Carbon Cty. Coal Co., 799 F.2d 265, 275 (7th Cir. 1986) (force majeure clause "not intended to buffer a party against the normal risks of a contract").

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