A global perspective

International trade issues in the diversified industrials sector

July 10, 2019
Mark Herlach, Jeffrey Bialos, Vedia Biton Eidelman, James Lindop
International trade at a crossroads
Weapons of mass disruption
Trump and Trade – The key themes

1. Unilateral
2. Indiscriminate
3. Bilateral
4. Transactional
A unilateral approach

“Nearly a year-and-a-half into his presidency, Trump is hitting his stride on the part of the job that he seems to love the most: going it alone...”

The Washington Post

- Section 301 Tariffs on Chinese products
- Section 232 Tariffs on aluminum and steel (autos?)
- Huawei indictments and designation
- Withdrawal from Joint Comprehensive Plan of Action (JCPOA)
- Threat to impose tariffs on Mexico
Retaliatory tariffs on Chinese imports
By the numbers...

3 Tranches of additional US tariffs:
- List #1 - Effective July 6, 2018
  - 25% import tariff on 818 Chinese imports ($34 billion)
- List #2 - Effective August 23, 2018
  - 25% import tariff on 279 Chinese imports ($16 billion)
- List #3 - Effective September 24, 2018 (10%); increased May 10, 2019 (25%)
  - 25% import tariff on 5,733 Chinese imports ($200 billion)

1 Proposed tranche of additional US tariffs:
- Proposed list #4 - TBD
  - 25% import tariff on 3,812 Chinese imports (approx. $300 billion)
A key implement in Trump’s toolbox – Section 232
President authorized to adjust imports from other countries when they threaten “national security”

– Secretary of Commerce must initiate investigation at the request of the head of any department or agency, interested party, or on own motion

– Investigation period lasts up to 270 days

– President has 90 days to act following receipt of report

– President may “adjust the imports . . . so that such imports will not threaten to impair the national security”

Source: CRS Graphic based on BIS data (https://www.bis.doc.gov/).
China and Iran are not the only targets
“The Art of the Deal” – bilateral and transactional

- Termination of TPP
- Threatened termination of NAFTA and KORUS
- Potential FTAs with the EU, UK, and Japan
- WTO under attack
- Multilateral arrangements (NATO, JCPOA, Paris Climate Accord, etc.) devalued
EU/UK international trade update
EU/UK international trade update

EU and US trade battles

– Trade relations between the EU and the US have been strained since June 2018 when President Trump decided to target EU steel and aluminum imports with tariffs
  • The EU responded with retaliatory tariffs on US imports (including jeans, bourbon and Harley-Davidson motorcycles)

– The US has also threatened to impose import duties on European cars and car parts

– 14-year fight over subsidies for aviation companies
  • At the beginning of July, the US proposed placing tariffs on an additional $4bn of imports from the EU (including cherries, cheese, olives, whiskey and coiled copper), and is awaiting the WTO’s approval (the 89 additional categories of goods were added to the original list of products worth $21bn, announced in April 2019)
  • The EU is currently waiting for WTO’s approval of its April 2019 proposal to impose retaliatory tariffs on US imports worth $20bn as a consequence of the WTO’s decision that found the US tax breaks in the sector amounted to subsidies
Since 17 May 2019, the EU has a new sanctions regime, for targeted sanctions to “deter and respond to cyber-attacks which constitute a threat to EU Member States, third States or international organisations”

Travel bans and asset freezing measures can be imposed on those “responsible for cyber-attacks or attempted cyber-attacks, who provide financial, technical or material support for such attacks or who are involved in other ways”

To fall within the scope of the regime, the cyber-attacks must have a significant impact, and originate from, use infrastructure or be carried out by those operating outside the EU

No persons have been sanctioned under this regime to date
EU/UK international trade update

UK Government loses case relating to Saudi Arabia arms exports

• 20 June 2019 UK Court of Appeal ruled decision to continue licensing arms exports to Saudi Arabia for possible use in Yemen was unlawful

• Deficiencies in considering Saudi Arabia’s record in respect of international humanitarian law as part of the decision making process

• Government not obliged to suspend existing licenses or refrain from granting new ones

• But International Trade Secretary said no new licenses will be issued while Government considers the implications and while permission to appeal is sought

• ECJU stopped new registrations for six OGELS

• Existing licenses not immediately affected

• Change in licensing policy would affect companies that export military equipment where the end-user is based in Saudi Arabia and the intended end-use is linked to the Yemeni civil war
Can the Iran nuclear deal be saved?

---

Iran announced the following measures to reduce their commitments under the JCPOA:

- The production of enriched uranium increased x4 and Iran already exceeded the 300kg uranium enrichment cap stipulated in the JCPOA on 27 June.
- Heavy water production and supplies could exceed the 130-tonnes limit in the next couple of months if Iran is not given access to a new market.
- On 7 July Iran started the process of enriching uranium to up to 5% to meet the needs of the Bushehr power plant and up to 20% for a research reactor (the JCPOA limit is 3.67%).

Iran says these steps are a result of a lack of ‘concrete action’ and ‘positive signs’ by the EU of compliance with the JCPOA, and that they are ‘reversible’ if the EU deliver on its commitments.

---

20 June 2019 the EU External Affairs Sub-Committee held an evidence session in the HoL on the future of the JCPOA.

- Iran has moved from strategic patience to strategic action.
- Unless Iran sees action not just from the EU but also from Russia and China, it will no longer continue to fully comply with the deal.
- The EU and Russia could look for a country that is a nuclear power to buy Iran’s stockpile, taking away Iran’s excuse for exceeding the threshold.
- The EU wants to see INSTEX operational and show Iran that a transaction has successfully been completed using it (although the US indicated they might sanction INSTEX).
EU/UK international trade update
Legal uncertainty relating to US sanctions and EU Blocking Regulation

- 21 June 2019 report by the UK Financial Markets Law Committee
- Meaning of ‘active’ or ‘deliberate’ compliance with US sanctions versus whether it is possible to ‘comply with’ US secondary sanctions (not phrased as prohibitions)
- Commercial assessment which results in a conclusion that it would be economically risky to engage in certain activities given the active enforcement of sanctions by US authorities would arguably not breach EU Blocking Regulation
- Limited guidance on the types of situations that would potentially qualify for an authorisation + no public information on whether any applications have been made or granted
- Application to trade compliance clauses:
  - Whether requiring compliance with sanctions and/or agreeing to comply with a breach of EU Blocking Regulation
  - UK court decision in Mancanocchet Mining v. Aegis: mere reliance upon the terms of a sanctions clause to resist performing a contractual obligation cannot be construed as an act of ‘compliance’ with a third country’s sanctions regime and thereby would not breach EU Blocking Regulation
Sanctions key developments – Iran and Venezuela
Types of sanctions

Comprehensive “country sanctions"

- Crimea, Iran, North Korea, Syria, Cuba

Targeted, list-based designations (“Specially Designated Nationals”)

- SDN, SDNTK, SDGT, FSE

Sectoral sanctions (“Sectoral Sanctions Identification List”)

- Russia and Ukraine-related, Venezuela

Secondary/extraterritorial sanctions

- Blacklisting of non-US persons that do business with certain sanctioned persons, or engage in certain types of sanctioned activities
### Key terms and concepts

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Facilitation&quot;</td>
<td>Approving, financing, facilitating, or guaranteeing any transaction by a non-US person when the transaction would be prohibited if performed by a US person.</td>
</tr>
<tr>
<td>Blocking/Freezing</td>
<td>Obligates any party in possession or control of funds or property of a sanctions target to block or freeze (and potentially report) those assets.</td>
</tr>
<tr>
<td>50% Rule</td>
<td>Where there is a restriction against a designated sanctions target, the same restriction automatically applies to entities which the target owns a 50% or larger interest.</td>
</tr>
<tr>
<td>Licenses</td>
<td>General License means no further authorization required. Specific License requires authorization in advance - highly discretionary review.</td>
</tr>
</tbody>
</table>
Iran

The Return of Secondary Sanctions

Primary Sanctions: apply to US persons only
Secondary Sanctions: apply to all persons

“And starting today, Iran will have zero oil revenue .... Let me say that again. Zero. One hundred percent of the revenue that Iran receives from the sale of crude oil will be held in foreign accounts and can be used by Iran only for humanitarian trade or bilateral trade in nonsanctioned goods and services.”

Secretary of State Mike Pompeo,
November 2, 2018 briefing on Iran Sanctions
Venezuela

– No general embargo, and no country-based sanctions

– The US continues to expand sanctions targeting Maduro regime officials and businesses
  • SDN sanctions designations
    • PdVSA - though exclusions (and general licenses) apply, especially for Citgo
    • Maduro regime officials, their business associates, and assets (e.g., aircraft)
    • Financial institutions
  • And new designation authorities for “gold” and any other sector, and for corruption - plus family members

– Prohibitions on US persons dealing in certain Government of Venezuela debt and securities, and in the Venezuelan “Petro” cryptocurrency

– Secondary sanctions possible if assistance is “material”
Petroleos de Venezuela SA (PdVSA) Sanctions

Non-US companies and banks engaged in funds transfers, certain oil trades and shipments (diluent, gasoline, jet fuel), and activities involving Cuba have become an enforcement target.

1/28/19

Wind-down of pre-existing contracts*

2/27/19

USP employees abroad

3/27/19

US imports of PdVSA products**

4/27/19

General License 8

7/27/19

CITGO/Nynas only transactions; Licensed upstream operations in Venezuela

No payments directly or indirectly to/for PdVSA!***

No US exports/re-exports of diluent!

**Not including US diluent exports or re-exports

**No payments to or for the benefit of PdVSA (and non-excluded subsidiaries)

***PdVSA includes 50% or more subsidiaries

*Not including US diluent exports or re-exports
Challenging regulatory environment for foreign investments and global supply chains
Changing US regulatory environment, driven by “near peer” competition, is adding to the challenges facing global trade and investment

- **Exon-Florio** – National Security Reviews of foreign more challenging – expanded coverage and new mandatory filing requirements due to China reset

- **Export Controls** – Shift in focus from decontrol to expanded restrictions on “critical” dual use technologies to maintain US technology leadership

- **Buy America Act and Berry Amendment** – Rule based content limitations
  - Trump Administration policy to limit use of exemptions

- **Defense Industrial Policy** – Focus on supply chain security and limiting reliance on foreign suppliers

- **Executive Order** authorizing restrictions on use of foreign equipment for telecom declared National Security Risk (Huawei)

*The cumulative effect of new unilateral US policies designed to contain China will likely make it more difficult for the US to collaborate with allies in dual use technologies*
CFIUS Reviews – while most cases historically cleared, a growing number mitigated or prohibited (20% in 2017) – largely involving China

<table>
<thead>
<tr>
<th>Year</th>
<th>Notifications</th>
<th>Investigations</th>
<th>Withdrawals*</th>
<th>Presidential Decision</th>
<th>Mitigation Agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>155</td>
<td>23</td>
<td>23</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>2009</td>
<td>65</td>
<td>25</td>
<td>7</td>
<td>0</td>
<td>5</td>
</tr>
<tr>
<td>2010</td>
<td>93</td>
<td>35</td>
<td>12</td>
<td>0</td>
<td>8*</td>
</tr>
<tr>
<td>2011</td>
<td>111</td>
<td>40</td>
<td>6</td>
<td>0</td>
<td>8*</td>
</tr>
<tr>
<td>2012</td>
<td>114</td>
<td>45</td>
<td>22</td>
<td>1</td>
<td>8*</td>
</tr>
<tr>
<td>2013</td>
<td>97</td>
<td>48</td>
<td>8</td>
<td>0</td>
<td>11</td>
</tr>
<tr>
<td>2014</td>
<td>147</td>
<td>51</td>
<td>12</td>
<td>0</td>
<td>9</td>
</tr>
<tr>
<td>2015</td>
<td>143</td>
<td>66</td>
<td>13</td>
<td>0</td>
<td>11</td>
</tr>
<tr>
<td>2016</td>
<td>172</td>
<td>79</td>
<td>27</td>
<td>1</td>
<td>Not yet available</td>
</tr>
<tr>
<td>2017</td>
<td>~240</td>
<td>~168</td>
<td>Not yet available</td>
<td>Not yet available</td>
<td>Not yet available</td>
</tr>
</tbody>
</table>

- Number of cases dramatically increased in recent years
- Canada was second (49), UK third (47) and Japan fourth (40)
A series of trends creating more risk for high tech transactions and collaboration worldwide

 Concerns over Chinese investment have resulted in a more robust CFIUS process for all transactions in recent years
  - Longer timelines for reviews
  - Deeper investigative scrutiny – more information sought from parties

 Changing and more complex deal structures creating more situations involving foreign control over US businesses
  - More complex private equity funds and similar arrangements where foreign investors no longer have only passive roles

 Expanded focus of CFIUS beyond traditional security risks
  - Protection of “personal identifiable information” from exploitation by foreign buyers
  - Hotels and other businesses proximate to US government installations
  - Enhanced focus on foreign collaboration in emerging and foundational (critical) technologies

 More CFIUS risk ➔ more deal complexity, time and costs for wider range of transactions and collaborative engagements
 Focus on China increasingly forces foreign firms to make binary choices
Foreign Investment Risk Review Modernization Act (FIRRMA) and Export Control Reform Act (ECRA) together accelerate and deepen trend toward longer, more robust CFIUS reviews

— FIRRMA expands covered transactions subject to CFIUS review, makes some CFIUS notifications mandatory, and increases CFIUS timelines; coverage expanded to:
  • Certain non-passive minority investments in US businesses with critical technology, critical infrastructure or sensitive personal data
  • Purchases of real estate near military bases and other sensitive installations
  • Country exemptions? - No “whitelist” or “blacklist” – vague exception instead
    • Some discussion of using “National Technology Industrial Base” countries (Canada, UK, Northern Ireland and Australia) or “Five Eyes” countries (Australia, Canada, New Zealand, UK) as one exemption criteria

— ECRA adds new categories of “Emerging and Foundational Technologies” subject to export controls
  • “Emerging and Foundational Technologies” are a category of “critical technology” that will shape new CFIUS coverage of covered transactions

— Counterpoint: DoD “Trusted Capital Marketplace” authorized by NDAA – pilot matchmaking program designed to offer US tech firms alternative to foreign investment

One of most significant expansions of federal regulation of business in many years
New CFIUS Pilot Program rules create mandatory filing requirements for investments in critical technology companies

Mandatory CFIUS filings now required for controlling or non-passive minority investments in US firms that:

- are utilizing a range of “critical” technologies (including defense, dual use, nuclear, and “emerging and foundational” technologies to be designated by Commerce under ECRA) in one of 27 “Pilot Program Industries”; or
- have designed such technologies specifically for use in one of these 27 sectors

27 “Pilot Program Industries” cover major parts of the economy

- Aircraft and aircraft engine manufacturing, aluminum production, ball bearings, computer manufacturing, computer storage device manufacturing, nanotechnology, nuclear, petroleum, semiconductors, wireless communications, and other specified sectors

Exemption for foreign investments through traditionally managed private equity funds: more novel structures not exempt

- Mandatory filing requirements for expanded range of transactions likely in new CFIUS regulations expected in second half of 2019
- Will CFIUS exempt some allies from requirements or apply them across the board?
- Likely outcome – Rules will apply to most countries, chill high tech collaboration with allies and limit US access to foreign innovation to US detriment
Define/identify “emerging technologies” important to National Security for which “effective controls” can be implemented that “avoid negatively impacting US leadership in science, technology, engineering, and manufacturing sectors”

- Biotechnology
- Artificial Intelligence
- Position, navigation and timing technology
- Microprocessor technology
- Data analytics technology
- Quantum information and sensing technology
- Logistics technology
- Additive manufacturing
- Robotics
- Brain-computer interfaces
- Hypersonics
- Advanced materials
- Advanced surveillance technologies (faceprint and voiceprint technologies)

- New unilateral Export Control restrictions emerging from Commerce review could impact cooperation with allies in key dual use technologies – to detriment of US war fighters
Significant growth of unilateral US measures to address supply chain risk pose challenges and potentially limit cross-border cooperation

- Executive Order on securing information/communications technology supply chain – National security or a bargaining chip for broader trade negotiations?
  - If the US determines under Order that a transaction poses a risk to US information and communications technology or services, it could prohibit Chinese firms from providing any information and communications technology or service to US persons
  - Huawei and 68 affiliates placed on the Commerce “Entity List;” US persons prohibited from exporting to them technology, software or services subject to US export jurisdiction

- President Trump recently delayed implementation pending trade negotiations with China

- Trump Administration Defense Industrial Base Study: Identifies over 300 vulnerabilities to address and recommends spending to limit reliance on foreign allies

- 2019 NDAA Section 881: Agency can exclude from procurement a source of supply that fails to meet qualification standards established to reduce supply chain risk if it finds significant risk exists

- Pentagon “Do Not Buy” software list based on “security risk;” specified vendors from two Countries (China, Russia) included

- Cyber Security: DFARS Rule (NIST Standards); Defense Agency reviews of contractors beyond NIST standards

Firms need to understand unilateral US supply chain measures and adopt measures to mitigate risks and ensure market participation