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COVID-19 EXPOSES NEW SUPPLY CHAIN RISKS

Giovanna M. Cinelli

Kenneth J. Nunnenkamp

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WHAT HAS HAPPENED?

- ❖ Shifting geopolitical considerations and an interconnected vertical supply chain have highlighted the importance of reliable access to products, services and related technology
- ❖ The need for a reliable supply chain is neither new nor unexpected. Companies and governments have always established supply chains to address some or all of the following factors
 - High quality and consistent products
 - Timely delivery
 - Effective and short notice support for troubleshooting and product replacement
 - Multiple sources from which to obtain products
 - Cost-effective pricing that does not sacrifice quality, timeliness, and consistency

SUPPLY CHAIN ISSUES

- ❖ Industries manage risks to address supply chain requirements
 - Certain industries – defense, military, intelligence, technology development – have managed and prioritized risks more consistently given the consequences of failure
 - The same applies to industries that service governments – whether the US or non-US – based on the need to protect the warfighter, ensure appropriate spending of the public fisc, and manage long-term needs
 - Determining the appropriate level of risk is generally based on common factors: ***Threats + Vulnerabilities = Consequences***
 - When the factors remain stable, risk tolerances can increase as the potential consequences may be more readily discernable

SUPPLY CHAIN ISSUES

- ❖ Industries manage risks to address supply chain requirements
 - When risks vary due to geopolitical factors, non-governmental actors, and unanticipated challenges (such as pandemics, dissipation of natural resources, etc.), the risk tolerances generally shift
 - The current COVID-19 situation highlights the types of unanticipated challenges that can create shortages where none existed before, shift timelines for deliveries and uncover weaknesses or chokepoints in the supply chain
 - Managing these changes, however, after the challenge arises limits the options available to resolve the challenges, as well as the flexibility needed to ensure there is ample time to implement the resolutions

SUPPLY CHAIN ISSUES

- ❖ Industries manage risks to address supply chain requirements
 - Industries overall have enjoyed relatively stable supply chains for the last several decades
 - This stability has created a level of comfort – if not, complacency – that inadvertently enhanced several risks beyond acceptable levels
 - ◆ Loss of indigenous capabilities
 - ◆ Hidden costs related to transportation, delays, government intrusion and changes in laws and regulations that adversely affect the supply chain
 - ◆ Impact on more than traditional industries – i.e., it is not only the defense, aerospace, military, intelligence, critical infrastructure, or similar industries that are affected by supply chain vulnerabilities
 - ◆ The focus on dual use products, technology, software and services expands the nature of risk, the parties affected, and the ultimate consequences

SUPPLY CHAIN ISSUES

- ❖ Areas where risks occur (regardless of industry segment)
 - Location in the supply chain – geographic
 - Location in the supply chain – vertical (first, second, third tier or lower)
 - Types of products, software, services, and technology
 - Laws and regulations that impact the relationships
 - ◆ Export and import controls – for example, Export Administration Regulations (EAR), International Traffic in Arms Regulations (ITAR)
 - ◆ Federal government regulations – for example, Defense Federal Acquisition Regulations
 - ◆ Laws that affect technology development, research and exchanges – for example, intellectual property laws, EAR, ITAR, controlled unclassified information (CUI)

SUPPLY CHAIN ISSUES

- ❖ Areas where risks occur (regardless of industry segment)
 - Foreign policy implementation
 - Political conflicts based on economic considerations
 - Foreign direct investment – for example, restrictions on such investment or a neglect of oversight of such investments (especially in particular industries)
 - Common production lines – for example, commercial and intelligence product development at the same facility and the same line
 - Common research and development facilities – for example, common university research relationships, development of technology based on defense requirements that migrate to commercial applications (i.e., encryption) and vice versa (i.e., artificial intelligence)

WHAT HAS CHANGED?

- ❖ COVID-19 has identified gaps in the supply chain of which governments and industry were previously aware, but considered to be acceptable risks
 - Product and development shift from the United States to China, Mexico and other countries
 - Increase in joint ventures and joint development with countries whose policies vary from the United States and its allies
 - Acceptance of chokepoints – i.e., rare earth minerals, electronic parts and components, software development, drones, telecommunications systems
 - Incremental and aggregate losses of technology

WHAT INDUSTRIES HAVE BEEN MOST AFFECTED?

- ❖ In the COVID-19 environment
 - The medical, pharmaceutical, research, hospital, and supporting industries have been directly impacted by
 - ◆ The nature of the pandemic
 - ◆ The genesis and global response to the pandemic
 - ◆ The availability of consistent and cohesive information regarding the biological construct of the virus
 - ◆ The patchwork of laws and regulations (across jurisdictions within the United States and abroad) that impact the development of tests, vaccines, equipment and protective products to remediate the pandemic

WHAT INDUSTRIES HAVE BEEN MOST AFFECTED?

- ❖ Areas of concern for industry, governments, nonprofits and academic institutions
 - The existence of commercial documentation that was not designed to address the issues raised by a pandemic
 - The failure to maintain alternative sources of supply – based on expense or an understanding that the risks did not merit the cost of supporting more than one supplier
 - Being prepared for the invocation of national security authorities in the United States and abroad for situations such as COVID-19

AREAS OF CONCERN

- ❖ Commercial documentation
 - Terms and conditions that did not address
 - ◆ Defense Production Act or other emergency authorities and the requirement to reallocate production and output
 - ◆ Allocation of tariff payments that increase product and technology costs
 - ◆ Overbroad descriptions of products and technology subject to terms and conditions
 - ◆ Proper marking and inclusion of mandatory flowdown requirements – i.e., Defense Priorities and Allocations (DPAS) ratings for specific orders
 - ◆ Failure to update supporting documentation – i.e., new powers of attorney for customs brokers to move products across borders
 - ◆ Failure to address outsourcing within the supply chain

AREAS OF CONCERN

- ❖ Management of resources to limit the impact of supplier loss or inconsistent performance
 - Know your supply chain
 - ◆ Who are your immediate suppliers
 - ◆ Where are they located – US or abroad
 - ◆ With whom do your suppliers work
 - ◆ Do they outsource
 - ◆ Are they subject to laws and regulations that conflict with US laws and regulations
 - Need to know the full depth of the supply chain – extend beyond the first and second tiers

CASE STUDY: COVID-19 ACCESS TO PPE

- ❖ The President of the United States invoked his authority under the Defense Production Act (DPA) to declare a national emergency and to designate critical and strategic materials
 - This designation allows the President to require organizations that are subject to US jurisdiction to reallocate their product and services output, as well as modify their production
 - This designation also allow the President to affect exports and imports to ensure that adequate supplies of critical materials may be allocated within the US (or for US resources) as needed
 - This DPA authority allows the US Government to issue 'rated orders' which assign priority ratings to specific procurements

CASE STUDY: COVID-19 ACCESS TO PPE

- ❖ Rated orders
 - When the US Government issues a rated order, a company may
 - Accept the order
 - Reject the order
 - Request modification of the order to address specific supply chain or other issues that affect the company's ability to meet the requirements
 - ◆ The Department of Commerce manages the rated order process and indicates what justifications may be presented to reject or modify a rated order
 - ◆ If a company accepts a rated order, the company is expected to include the rating in its subcontracts or supply chain terms and conditions and require that the suppliers or subcontractors include the rating in their transaction documents

CASE STUDY: COVID-19 ACCESS TO PPE

❖ Export regulations

- FEMA given greater role for PPE-related items
- Expanded use in the US of the DPA authorities
- Presidential Memorandum on Allocating Certain Scarce or Threatened Health and Medical Resources to Domestic Use of April 3, 2020
 - ◆ Authorized FEMA to take “any and all authority available under [the DPA] to allocate to domestic use, as appropriate, [identified] scarce or threatened materials”
 - N-95 Filtering Facepiece Respirators
 - Other Filtering Facepiece Respirators
 - Certain types of air-purifying respirators and particulate filters/cartridges
 - PPE surgical masks
 - PPE gloves or surgical gloves
- Broad authority given to FEMA to seize products designated for export
- Required CBP to hold such exports until cleared by FEMA

CASE STUDY: COVID-19 ACCESS TO PPE

- ❖ Export regulations
 - New regulations a moving target that will now ebb and flow according to requirements and demand
 - Expect restrictions on vaccine and vaccine materials once a preferred vaccine is identified
 - Potential impact on everything from vaccine delivery to constituent products
- ❖ The world is in reactive mode, and thus the essential element of predictability eludes us

CASE STUDY: COVID-19 ACCESS TO PPE

- ❖ Import regulations
- ❖ Changes in regulations relating to the movement of goods and people
 - Immigration halt in the US
 - ◆ 60 days; may be extended
 - ◆ Effective April 23, 2020
 - ◆ Many exemptions, but designed to protect US labor market
 - ◆ Rescission may hinge on reopening schedules, which are dictated by states
 - Focus and emphasis in the short term has been on PPE
 - ◆ Early shortages shaped policies still in effect
 - ◆ Regulated by US Customs and Border Protection (CBP) and Food and Drug Administration (FDA)

CASE STUDY: COVID-19 ACCESS TO PPE

❖ Import regulations

- CBP and FDA focus has been on *accelerating* entries of PPE and anything COVID related
- While simultaneously trying not to slow down normal commerce
- CBP assigned special COVID/PPE teams
- FDA temporary authorizations relating to imports of PPE
- Temporary relief from certain duty payments upon showing of "significant financial hardship due to COVID-19"
- Imports subject to duties associated with antidumping and countervailing duties (AD/CVD), and Section 201, 232 and 301 Trade Remedies are not included

QUESTIONS??

MORGAN LEWIS CORONAVIRUS/COVID-19 RESOURCES

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

Find resources on how to cope with the post-pandemic reality on our [NOW. NORMAL. NEXT. page](#) and our [COVID-19 page](#) to help keep you on top of developments as they unfold.

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to [subscribe](#) using the purple “Stay Up to Date” button.

Biography



Giovanna M. Cinelli
Partner

Washington, DC

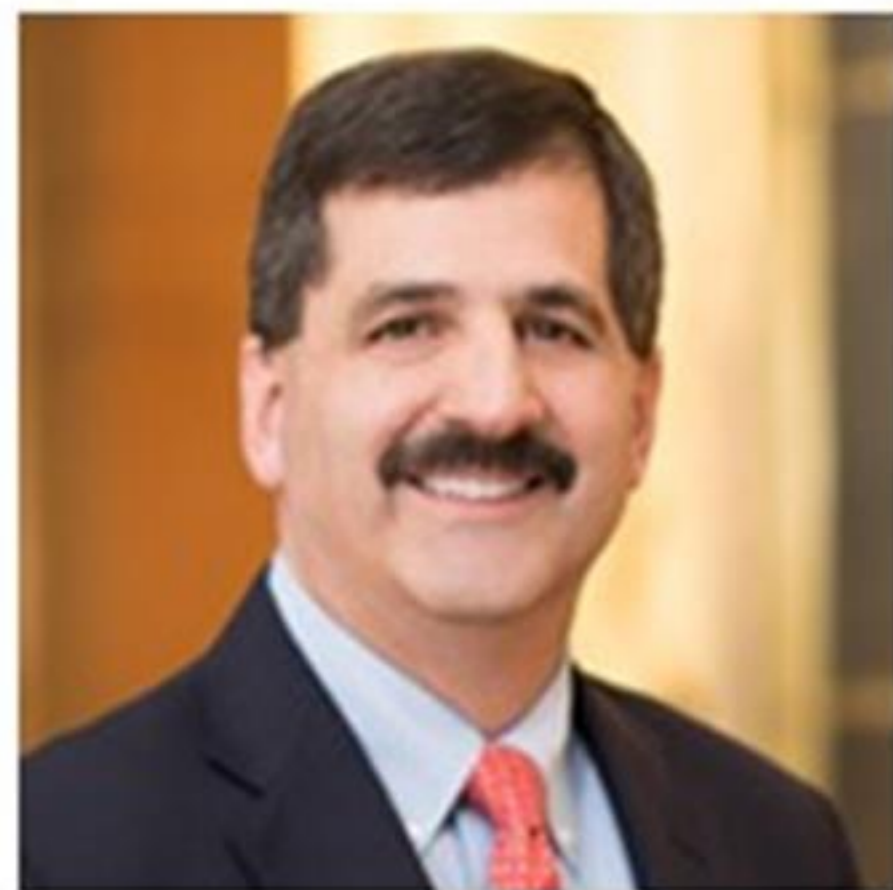
+1.202.739.5619

giovanna.cinelli@morganlewis.com

[Click Here for full bio](#)

Giovanna M. Cinelli is the leader of the Firm's International Trade and National Security Practice. She has practiced for over 30 years and has counseled clients across industry sectors on a range of issues related to export controls, foreign direct investment (FDI), supply chain, cyber and government procurements. She has conducted hundreds of investigations and cross-border diligence reviews to address national security concerns. She is a member of the Defense Trade Advisory Group, the Virginia/DC District Export Council and is a Visiting National Security Fellow at the National Security Institute of George Mason University. She has testified before Congress as a subject matter expert on national security issues affected by FDI and is a member of the Board of Advisors to the Center on Cyber and Technology Innovation.

Biography



Kenneth J. Nunnenkamp
Partner

Washington, DC

+1.202.739.5618

kenneth.nunnenkamp@morganlewis.com

[Click Here for full bio](#)

Ken Nunnenkamp represents clients in international trade and national security matters before United States federal courts and government agencies, including the US departments of State, Commerce, Homeland Security, Defense, and Treasury. His practice involves internal investigations and disclosures, including voluntary disclosures and responding to government demands, as well as federal court defense against government actions. He also advises on compliance counseling and training, transactional due diligence—including both domestic and cross-border transactions—and statutory submissions to US government agencies.

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