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On your radar

Quarterly aerospace, defense and security sector briefing

Q2 2020

The Coronavirus pushes the sector into an era of "new normal" - rethinking supply chains, navigating the global landscape and rethinking data flow.

Companies in the sector have been faced with significant challenges, as the market has focused on survival and shoring up liquidity with airlines applying for government bailouts, deferring new aircraft orders and curtailing aftermarket spending. Some of the key drivers and risk areas identified during Q2 2020, that continue to present challenges and opportunities within the sector are as follows:

1. When it comes to managing future risk, there's no time like the present

Aerospace and defense companies are continuing to experience a number of supply chain challenges as they look to manage risk long-term. With the world changing and budgets set to be considerably impacted over the coming years. More than ever management teams must rethink and redesign existing approaches to go beyond short-term recovery and set a long-term strategic supply chain vision, in order to protect a company's interests.

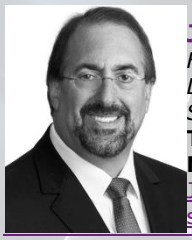
2. Reshaping the global trade landscape

Global lockdowns and border closures have significantly impacted demand for travel globally, which are likely to bring longer term changes to the sector in terms of passenger behavior and government restrictions particularly around protectionism which has been driven through stronger screening of foreign investment across the globe.

3. The seismic shift after Schrems II: The future of cross border data flows

In the future, change management will be taken more seriously. This will further accelerate companies' focus on new systems such as smart factories, robotics and other digitization efforts. The future of international data flow and use of data transfer mechanisms, in particular between the European Union and the United States, has recently been called into question and will need to be monitored more closely by companies going forward.

Aerospace, Defense & Security - Global Sector Team leads



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1 When it comes to managing future risk, there's no time like the present

The COVID-19 pandemic has been one of the most disruptive events to ever hit global supply chains. The industry is working to limit the risk from similar future events by re-assessing supply chain operations and taking steps to improve supply chain resiliency.

But to effectively manage risk, this hard look at supply chain operations should be extended to commercial contracts, which not only set the terms of the parties' intended transaction, but also allocate the risks of things going wrong.

Contractual Risk Allocation

The COVID-19 pandemic has shone a spotlight on force majeure provisions—with many learning that boilerplate versions of such clauses may not operate quite as previously assumed—but there are many more fundamental contractual risk allocation provisions, such as representation & warranty, limitation of liability, and indemnification provisions that require attention. The potential effect of these provisions is far too important and dependent on context—including, among others, the types of products and services being sold or purchased, the relationship between the parties, the value of the transaction, whether the transaction is cross-border, etc.—to rely on boilerplate language.

Representations and Warranties

If a contractual representation turns out not to have been true at the time of contract formation, or if a fact covered by a contractual warranty becomes untrue before the warranty period expires, there may be a breach of contract for which the breaching party is liable to the other party for damages caused by the breach. Thus, representations and warranties can protect parties against certain risks from having to rely on the other party for particular information relevant to the transaction, and help the parties define particular circumstances when a party will be liable to the other.

Limitation of Liability

A limitation of liability provision establishes limits on the scope of liabilities owed by a party to the other should a given event occur.

Thus, to effectively draft and negotiate an appropriate limitation of liability provision, the party must understand when and to what extent both it and the other party could be held liable. That typically depends on the contract itself as well as the local law that applies to the contract, particularly concerning the types of damages recoverable under contract (i.e., "direct" or "general" damages that naturally and exclusively flow from the breach versus "indirect", "special" or "consequential" damages caused by the breach but dependent on the non-breaching party's particular circumstances).

Limitation of liability provisions can set limits to or entirely exclude particular types of damages, damages associated with particular breaches or events, and amounts of damages.

Indemnification

Indemnification is the act of compensating a party for losses that party has incurred in connection with a specified incident.

Contractual indemnification provisions facilitate risk allocation by identifying specific losses that a party may incur for which the other party will be responsible and provide more clarity and predictability on a question of a party's liability than might otherwise exist under local law.

It is important for any indemnification obligation to clearly define:

- the party or parties undertaking the obligation to compensate the other party for a particular loss (the Indemnitor(s));
- the party or parties to which the indemnification obligation is owed (the Indemnitee(s));
- the damages for which the Indemnitor is obligated to compensate the Indemnitee;
- the particular event(s) triggering the obligation to compensate;
- limits or exclusions on the indemnification obligation; and
- the process to seek indemnification.

Dispute Resolution Provisions

Having the most well-crafted risk allocation provisions may be for naught if the other party can avoid or delay enforcement and drive up costs because of an unfavorable dispute resolution provision.

Just as with risk allocation provisions, a dispute resolution provision should be tailored to the circumstances of the particular transaction—particularly the type of transaction, the relationship between the parties, the value of the transaction, and the location of the parties. An intermediary mediation step followed, if necessary, by arbitration before a panel of three-arbitrators may be the best fit for a high value and long-term contract with a party based in a different country; whereas a short, abbreviated, low-cost arbitration proceeding might be a better choice for a low value sale.

Absent a well-crafted dispute resolution provision, a party may find itself hauled into the court system of its counterparty, where it may find it more difficult to secure a neutral hearing of the claim. At the very least, the other party will have a "home" advantage such that the litigation is less of a burden to it (e.g., travel, time zones, language).

With the impact of COVID-19 still fresh, and while investing a great deal of strategic thinking to forward looking risk management, now is an ideal time to evaluate whether the risk allocation and dispute resolution provisions in your commercial contracts are appropriate for the particular circumstances and to ensure your commercial contract personnel are sufficiently armed to protect your company's interests when negotiating these provisions.

2 Reshaping the global trade landscape

COVID-19 and border control issues

In order to contain the spread of coronavirus, we have seen unprecedented lockdowns in countries all over the world. From June, EU Member States have gradually been lifting travel restrictions and opening up their borders. The European Commission has proposed a coordinated mechanism whereby decisions adopted by States have uniform application across the EU. The European Commission has also taken measures to ensure continued and uninterrupted land, waterborne and air cargo services, of crucial importance for the functioning of the EU's internal market.

With Brexit looming in the background, the UK Government has recently launched its Border Operating Model which lays out the framework for how the UK will operate a full external border as a sovereign state when the Brexit transition period ends on 31 December 2020.

Recognizing the impact of COVID-19 on businesses, the government has decided to introduce the new border controls in three stages up until 1 July 2021 for imports from the EU. This will provide that, from 1 January 2021, traders of standard goods will have up to six months to submit full customs declarations. Export declarations and UK exit Safety and Security declarations will be required for all goods leaving the UK for the EU from 1 January 2021.

Sanctions

On 6 July 2020, the UK Government issued the Global Human Rights Sanctions Regulations 2020 ("Regulations") and accompanying guidance (here), intended to serve as a new independent sanctions program aimed at deterring and providing accountability for serious human rights violations. This marks the first time the UK has imposed sanctions under the Sanctions and Anti-Money Laundering Act 2018, which sets out the domestic legal framework enabling the UK to implement UN, multilateral, and autonomous sanctions regimes, post-Brexit.

The Regulations enable the UK Government to designate persons who are "involved" in serious violations of human rights, carried out by either a state or non-state actor and, accordingly, both state and non-state actors may be designated under the Regulations.

The designations under the Regulations mean that the sanctioned persons would be subject to travel bans or asset freezes. Violations of the prohibitions amount to criminal offences and are punishable by a maximum of 7 years imprisonment and/or a fine.

The Regulations are intended to enable the UK to champion human rights, good governance, and the rule of law by using the UK's leverage against those involved in serious violations of human rights.

State aid

International aviation has been severely disrupted by the coronavirus outbreak. The aerospace manufacturing industry in the month of May, for example, saw a 75% decrease in aircraft deliveries compared with the same time last year. Both the European Commission and the UK government have implemented unprecedented State aid measures to mitigate the economic consequences of the pandemic.

The airline industry, for example, has received more than EUR25 billion in indirect liquidity support since March 2020, of which EUR19 billion is targeted measures directly approved by the European Commission.

For example, the bailout package to Lufthansa, the largest to date, gives the German state a 20% stake in the company with the option to increase that by another 5%, by a blocking minority in case of an unsolicited takeover offer.

The EU has updated its Temporary Framework to allow Member States to support the economy generally during the pandemic by providing recapitalizations and subordinated debt to companies in need.

To ensure that COVID-19-related aid does not distort competition in the EU, the Temporary Framework sets out several safeguarding conditions which need to be considered when relief measures are awarded to companies.

Despite best efforts, it is likely that aid awarded by governments will vary greatly from one Member State to another, leading to distortions of competition across the EU, which can trigger complaints and audits. Ryanair, for example, is challenging numerous State aid awards in the European Courts for unfairly bailing out major competitors which they believe will distort the competition landscape for years to come.

Reshaping the global trade landscape

Foreign direct investment

We have seen an increasing number of jurisdictions introducing or tightening rules, which strengthen their ability to review and actively intervene in foreign direct investment ("FDI") transactions.

In May, the European Commission proposed a new recovery instrument called "Next Generation EU" which included recommendations for enhancing strategic autonomy in several specific areas, including strategic value chains and reinforced screening of foreign direct investment.

In June, the European Commission adopted a White Paper on distortive effects caused by foreign subsidiaries in the Single Market, proposing new tools to control activities of foreign-subsided companies that wish to invest in EU companies.

A public consultation will be open until 23 September 2020, in which the European Commission seeks views and input from stakeholders which will inform appropriate legislative proposals in this area.

United Kingdom

The government announced in June two significant amendments to the UK merger control regime, intended to enhance its powers to scrutinize certain FDI into the UK against the backdrop of COVID-19 and wider national security concerns.

These amendments include changes to the Enterprise Act 2002, which allow the government to scrutinize certain foreign investments to ensure they do not threaten the UK's ability to combat a public health emergency, such as the COVID-19 crisis.

These amendments are primarily intended to "mitigate risks in the short term" ahead of the National Security and Investment Bill, which will create a new distinct FDI regime in the UK, introducing standalone powers enabling the government to review a broad range of transactions on the grounds of national security.

Germany

In Germany, the Act to Amend the Foreign Trade and Payments Act ("Außenwirtschaftsgesetz", AWG) has entered into force on 17 July 2020.

Parliament has thereby significantly tightened the German regime for foreign direct investment (FDI) screening. A regulation to amend the Foreign Trade Ordinance ("Außenwirtschaftsverordnung", AWV) and to expand the scope of FDI screening to further industries will follow soon.

The Federal Ministry for Economic Affairs and Energy (BMWi) is firm in their belief that the German economy, infrastructures and technology should not be "sold away" to non-German or non-EU parties. The BMWi has already announced that it intends to expand the scope of "sensitive" industries further and to include key upcoming technologies.

It is therefore wise to assume that more industries and businesses will be subject to FDI screening. Parties to a transaction to which FDI screening rules may apply have to plan carefully, allow enough time and anticipate review and discussions with BMWi, or even action in court, because of the FDI review regime. Read our briefing here.

US

In the midst of the pandemic, the Committee on Foreign Investment in the United States (CFIUS) has proposed several revisions to its regulations, that change when short-form filings (called "declarations") are required with respect to covered foreign investments of US businesses which work with critical technology.

What is most significant for foreign investors is that the proposed rules expand the mandatory declaration and required CFIUS review to include critical technology transactions that range well beyond the 27 industries originally designated by CFIUS – to cover all sectors of the economy.

The raison d'etre for this proposed CFIUS rule change is not entirely clear. While the modification largely reads as being technical in nature, CFIUS does, however, observe that other, unspecified "national security considerations" are involved

Read our briefing here.

3

The seismic shift after Schrems II: The future of cross border data flows

If you transfer data from the EU to the US, or if your trusted service providers do, the Schrems II European Court decision has seismic significance—even if you do not rely on Privacy Shield. Recent FAQs issued by the European Data Protection Board further highlight the changes:

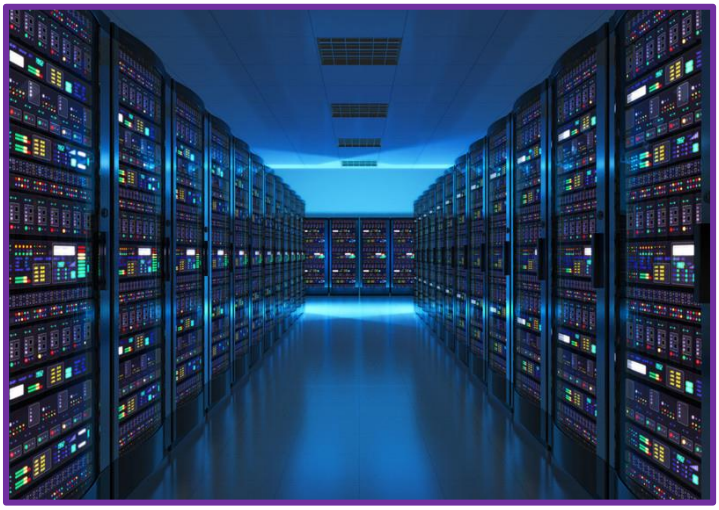
- The FAQs provide further clarification on whether there is a "grace period" for those companies that had relied on the Privacy Shield.
- Standard Contractual Clauses (SCCs) now require significant additional due diligence.
- Binding Corporate Rules now face some of the same issues as SCCs.

Key takeaways

Ultimately, if your company wishes to continue to apply Standard Contractual Clauses or Binding Corporate Rules as the solution for existing and new personal data transfers from the UK/EU to the US, it will be important to: (a) determine the extent to which US surveillance authorities apply to the relevant data streams; and (b) assess the level of protection your business, or your service providers and their sub-contractors, can provide for each data stream.

Consent is looked upon very skeptically by EU regulators in the employer-employee context, and it must always be freely given, specific and informed. Other derogations include, amongst others, where it is necessary to perform a contract between the controller and the relevant individual, where it is necessary for conclusion or performance of a contract in the interest of the individual and another person or company, or the transfer is necessary for establishing, exercise or defense of legal claims. The interpretation of when these derogations can be applied has, historically, been quite restrictive so there is some debate as to whether that will be adjusted as further guidance is developed — moving the potential for application more in line with the way such alternative use is referenced by the European court.

For further information, read the full briefing here



Implications of US laws on collection, storage, and use of biometric information

The use of biometric technology in everyday life has increased dramatically over the last few years. As a result, private entities are collecting, using, and storing biometric information from employees and consumers more than ever before. Unfortunately, the legal landscape for the private use of biometrics in the United States is unsettled.

In this comprehensive white paper, we explain that landscape for private entities that seek the many benefits inherent in biometrics while mitigating the attendant legal risks.

A small number of US state statutes specifically govern the collection, use, and storage of biometrics. Other states have proposed similar laws, and many breach notification laws have been amended to include protections for biometric information.

The Illinois Biometric Information Privacy Act (BIPA), which imposes strict liability and severe financial penalties, has been the subject of hundreds of class action complaints in the last five years. The case law relating to BIPA is rapidly developing.

Proposed federal legislation has yet to gain traction, but other federal activity in this space warrants consideration. State attorneys general and plaintiffs' lawyers are also becoming more active.

Read the full white paper here

For further support

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