Bird & Bird ATMD

Legal Update

US-China Trade War: Re-negotiation strategies and danger zones under Singapore Law

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Introduction

In our previous article published here in March 2019 on the US-China Trade War and its implications for contracts which cannot be performed due to the imposition of tariffs or quotas, we focused on how force majeure clauses may be used to escape potential liability for non-performance.

Since our article was published, tensions between the two largest economies have re-escalated. US hiked tariffs on more than US$200 billion in goods from China in what was said to be the "most dramatic step" yet of President Donald Trump' push to extract trade concessions. China immediately announced that it will retaliate and there appears to be little hope of a reconciliatory breakthrough. Telecoms giant Huawei has also suffered being subject to a sweeping ban on US national security grounds. Asian stocks are in turmoil and the global trading conditions look set to head towards gloomy uncertainties.

However, some, such as this article by Bloomberg, also expresses the view that for some companies, the spectre of the US-China Trade War also provides coverage for downsizing or exiting the China market due to weak fundamentals and rising costs, which have been broader trends underpinning the China market besides the tariff situation.

As such, companies may be taking the trade war and general uncertain economic outlook as a signal to reconsider existing relationships with business partners both in China and elsewhere. Perhaps those relationships have turned out to become a drain on resources, or this might be an opportune moment to revisit an arrangement to better an existing bargain.

In this legal update, we will explore some re-negotiation strategies and highlight the danger zones under Singapore law which companies may consider when revisiting existing arrangements – be it due to the risks associated with a trade war or a general desire to re-position and to limit exposure during this fraught period.

Framing the Re-Negotiation

Re-negotiations do not typically appear out of the blue. Business partners do become disgruntled and unsettled if a person seeks to re-negotiate an existing agreement for no good reason other than to get a better deal. It is therefore important to at least try to come up with ostensible justifications for a re-negotiation which would stand up to scrutiny, even if the actual agenda is nothing more than to improve the bargain.

A bit of good business judgment may well identify the right time to improve or reconfigure the terms of an existing relationship, or even to move away from a relationship.

A change of circumstances, such as a trade war, can provide just the fodder for discussion. The trade conflagration can provide a reasonable justification to downsize or exit the market, without causing undue offense to business partners.

If downsizing without fully exiting the market, consider whether other business partners will want to work with the company once word gets out that it is downsizing.

If word gets out, such a company might find itself without variable alternatives and more dependent on its local partner than ever before. This would not aid in re-negotiating from a strong position.

Consequently, it would be a good idea to approach alternatives early without making any announcements or indication of downsizing plans.

It would be difficult to keep any such downsizing plans confidential once the cat is out of the bag, especially since such news tends to be a hot topic for gossip.

Confidentiality and Intellectual Property Considerations

Another typical way to improve a bargaining position is to explore alternatives with other potential partners. Be careful not to breach confidentiality or intellectual property undertakings with existing partners when exploring new opportunities.

It is crucial to be aware as to whether existing agreements contain confidentiality clauses, which might limit what can be shared with potential new partners, for instance, clauses protecting the confidentiality of proprietary production techniques developed with local partners, and so forth.

Ownership of intellectual property may also turn out to be a potential hurdle, especially if the local partner has asserted ownership over intellectual property that cannot be easily transferred to a new partner.

Confidentiality clauses also usually limit what can be shared with advisers or third parties who may be able to provide advice on the re-negotiation. Such terms need to be waived, or otherwise mitigated to enable a conversation to take place.

When approaching potentials, non-disclosure and no shop provisions should be imposed on new prospective collaborators to avoid situations where there is a leak of plans to the existing partner or where a new prospect obtains proprietary information and misuses it.

Re-Negotiation Practices and Key Terms

Once a decision has been made to re-negotiate an existing relationship, be clear and direct with the other party on what fresh terms the relationship will continue.

Ensure first and foremost that termination will not result in damages and that there is a clear termination right. Timing wise, rather than prematurely terminating an agreement, choose instead to re-negotiate when an agreement comes up for renewal.

If there is no early termination right or an agreement is not up for renewal, it is not advisable to hint at a desire to terminate while stringing the other party along. Under Singapore law, a party can inadvertently be in anticipatory breach if its conduct and actions indicate that it is not going to perform its end of a bargain. Therefore, be careful if using the "pretend" to terminate strategy, since conduct and actions might actually be construed to mean that an agreement has been terminated even if that was not the intention.

Instead, make a decision and be firm about the desire to terminate unless the other party is able to meet fresh terms. At this stage, the other party might just concede already because there is generally a lot of pressure on companies to avoid losing their existing customers or key suppliers, especially in the present weak economic climate.

If proceeding to re-negotiation, consider whether it will be conducted in either of these 2 ways: (a) **closed**, with the existing parties negotiating terms; or (b) **open**, with the re-negotiating party actively exploring alternatives with new partners.

Generally, option (b) is preferred as it is akin to a RFP process. This way, the other party is able to tell that the terminating party is serious about re-negotiating since it is looking at other providers, and that there are indeed alternative options for the terminating party. Competitive pressure from such a process may therefore help the terminating party obtain a better negotiated outcome.

What types of clauses should be targeted in a re-negotiation? It would depend on the type of agreement being re-negotiated, but we suggest the following as a guide:

- Improving performance and incentive clauses.
- Reducing or removing any clauses that introduce termination costs.
- Consider a more holistic price mechanism, which includes variable pricing structures that are cognisant of price reductions associated with volume and technological advancements.

Established Danger Zones under Singapore Law Mandatory Injunctions

When seeking to re-negotiate an agreement, be mindful that the existing business relationship should generally continue un-affected by the re-negotiation. Meaning, goods due should be delivered and so forth.

If goods are not delivered according to the existing agreement, the party that does not deliver would likely be in breach. Normally breaches give rise to damages; however an order of court can compel the breaching party to deliver the goods, pending trial, where ordering the delivery would give the court a "high degree of assurance that at trial it would appear that the [order to deliver the goods] was rightly granted".

This happened specifically in the case of *Films Rover International v Cannon Film Sales* (1987). This is an English case where one party refused to deliver the promised goods as a strategy to use the non-delivery as a bargaining chip in re-negotiations; the other party in turn successfully sought an order of court to force the other party to deliver the goods (a mandatory injunction). The principles of the *Films Rover* case have been applied in Singapore in the cases of *Heysek v Boyden* (1998) and *Singapore Press Holdings v Brown Noel Trading* (1994).

Re-negotiating Performance Obligations

Another example of re-negotiations gone wrong comes from the Malaysian case of *ABB Transmission v Sri Antan* (2009).

In that case, a contractor was awarded the contract to design, manufacture and build certain electrical substations. This contractor then sub-contracted with a supplier for electrical equipment to be used in the substations.

In the interim, the Asian financial crisis of 1998 hit, and the contractor's main appointment to erect substations was affected. Consequently, the contractor purported to vary its agreement with the sub-contractor unilaterally, in order to reduce its obligation to purchase a fixed number of equipment from the sub-contractor. The contractor also sought to prolong its performance of the existing substation work, and in turn slow down the rate of procurement of goods from the sub-contractor.

The sub-contractor was not certainly agreeable to the changes and there were correspondences between the parties about whether the variation to the agreement was valid or not.

Eventually, however, the sub-contractor elected to sue the contractor for all outstanding sums on the basis that regardless of the contractor's purported unilateral variations to the contact, the contract was not varied but rather repudiated.

The sub-contractor succeeded and recovered the sums due based on the court's ruling that the contractor's overall conduct allowed the sub-contractor to treat the agreement as repudiated.

This was due to the contractor's overall poor conduct such as delays, mismanagement and overall unprofessionalism including disrupting its own sub-contractor's performance.

This case is an example of being sensitive during re-negotiations not to veer into conduct which would repudiate the contract, and give rise to legal liability in addition to failing to meet the original re-negotiation objective.

Re-Negotiating Agreements

Under Singapore law, it is settled that parties can vary an existing agreement by mutual consent. Such consent is usually documented in a signed document, and often the main agreement would contain a clause requiring any variation to be documented and signed in writing.

The Singapore courts have further held that such a variation document—so long as in writing and signed to meet the contractual variation requirements—need not specifically refer to or identify the agreement that it is varying.

In the case of *Cherie Hearts Group v G8 Education* (2012), the parties were embroiled with what seemed to have become an unhappy situation. G8 lent sums to Cherie Hearts under a Loan Agreement. As security for the loan, there was also an agreement for Cherie Heart's shares to be sold to G8 Education under an Acquisition Agreement. Those two agreements were later varied at several points.

When Cherie Hearts defaulted on the loan, G8 enforced its security and took over certain shares in companies under the Cherie Hearts group. In turn, Cherie Hearts alleged that G8 improperly enforced its security, because certain dates in the Loan Agreement had not been varied in the same way as the Acquisition Agreement.

The courts held that because the Acquisition Agreement followed from the Loan Agreement, and also came second in time to the Loan Agreement, the variation to the Acquisition Agreement also automatically affected the Loan Agreement – even though variation in writing did not specifically refer to the Loan Agreement as a document that it was varying.

As a result, Cherie Hearts which alleged the repudiatory beach of G8 Education in the suit was itself the party actually in breach.

This result arose because the court asserted that G8 Education properly followed the terms of the Loan Agreement (as varied by the amendment to the Acquisition Agreement), in enforcing the security.

Therefore, when re-negotiating agreements, be cognisant of the contractual framework and circumstances surrounding the entire relationship as opposed to focusing on a specific transaction.

Note on Bribes and Unlawful Gains

Involvement in negotiations increases the risk that bribes may be paid to induce a successful close to an agreement and the same goes for re-negotiation situations.

Under Singapore law, an employee is responsible to an employer for bribes received by the employee. The employee deemed a constructive trustee to the employer for those funds, and the employer can therefore recover such funds as a beneficiary from the employee's estate after such employee passes away. In addition, as a deemed beneficiary, the employer can also seek to recover not just the bribe amount but also the employee's secret profits and proceeds from the bribery sum (*Sumitomo Bank v Thahir Kartika* (1992)).

Conclusion

Contract re-negotiation can be a highly effective business strategy to deliver value for shareholders and enhance profitability for businesses.

Most re-negotiations are also not typically risky; however businesses should adopt a prudent approach and be sensitive and realistic in any re-negotiations. Knowing the potential pitfalls and danger zones will help to avert unintended adverse consequences.

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