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# Top Legal Issues Facing the Manufacturing Sector in 2022

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## Letter from Co-Editors

Change continues to be the operative word in 2022. Manufacturers of both industrial and consumer products face many of the same issues that bedeviled the industry throughout 2021, as well as a host of all-new challenges, including the impact of the war in Ukraine, labor shortages, and unprecedented inflation.

As the global economy faces the third year of the pandemic and second year of severe supply chain constrictions, manufacturers are no longer focused on figuring out when things will return to “normal.” Instead, they are applying lessons learned from the past few years to become even more agile and resilient as they evolve their operations to succeed in this “new normal.”

Supply chain disruptions continue to be at the forefront of the adaptation conversation, as companies employ strategies for managing extreme price increases, warehousing/inventory, and freight cost. Some are taking a closer-to-home approach through “nearshoring” of production and resources. Manufacturers also are feeling the pressure of a tight labor market coupled with the complex remote work landscape. Despite the many challenges, there is also the potential for great rewards through cloud adoption, artificial intelligence, and all things “Industry 4.0.”

Under the Biden Administration, the manufacturing industry is facing stiffer enforcement on a number of fronts. The executive order on “Promoting Competition in the American Economy” calls for vigorous antitrust enforcement, and the Consumer Product Safety Commission has continued its push towards increased enforcement in 2022 as well. In addition, there has been an uptick in false advertising class actions and particularly those challenging environmental, sustainability, and ethics practices of consumer products manufacturers.

Corporate environmental impact also is front and center at the Securities and Exchange Commission, which has issued guidance that would require greater disclosure by public companies of the risks and costs of climate change on their businesses. Although it is simply a proposal at this point, manufacturers should be considering how they will measure and report the environmental impact of their businesses.

After M&A activity surged to record levels in 2021, industry trends continue to fuel a robust acquisition market in 2022. Disruptions in the supply chain have manufacturers looking to acquire component suppliers. Large manufacturers continue to divest non-core or underperforming assets, creating opportunities for private equity buyers. Diminished labor supply and higher wages are driving automation plays. The move to electrified mobility has automotive suppliers competing for new technology. There is a premium on speed of deal execution (including in the conduct of due diligence) and on closing certainty given the competitive landscape.

Foley & Lardner’s [Manufacturing Sector team](#) continually examines these transformational shifts through the eyes of our clients and is well-positioned to help clients stay ahead of global trends and innovate in a dynamic marketplace.

As we embark on the second half of 2022, this **Manufacturing White Paper** examines the business and legal considerations that continue to impact the industry and offers the perspectives and insights of attorneys with deep experience serving as trusted advisors to manufacturing companies.

Regards,

[Michelle Ku](#), Partner, Litigation

[Chase Brill](#), Partner, Intellectual Property

[Jon Gabriel](#), Partner, Business Law

# Corporate Environmental Impact: SEC Proposes Detailed Climate-Related Disclosures

## Introduction

In response to increasing demand by the investment community over the last dozen years, the Securities and Exchange Commission (SEC) has published guidance calling for greater disclosure by public companies of the risks and costs of climate change on their businesses. The SEC's efforts to promote greater transparency on corporate environmental impact culminated on March 21, 2022, with the promulgation of a proposed rule setting forth a sweeping array of new requirements for detailed disclosure of those risks and costs, with particular attention to greenhouse gas (GHG) emissions. If adopted, the rule would impose on publicly-held manufacturers significant obligations not only to make these disclosures but also to establish an extensive system of disclosure and accounting controls needed to ensure the periodic capture, assessment, and dissemination of a company's exposure to climate-related risk and impact on the environment. Appropriate maintenance of any such system would require rigorous assessment of the adequacy of design and operating effectiveness of those controls.

## AUTHORS

Sandy Winer | [swiner@foley.com](mailto:swiner@foley.com)

Brooke Clarkson | [bclarkson@foley.com](mailto:bclarkson@foley.com)

Michael Kirwan | [mkirwan@foley.com](mailto:mkirwan@foley.com)

Eric Pearson | [epearson@foley.com](mailto:epearson@foley.com)

Sarah Slack | [sslack@foley.com](mailto:sslack@foley.com)

Pete Tomasi | [ptomasi@foley.com](mailto:ptomasi@foley.com)

Hillary Vedvig | [hvedvig@foley.com](mailto:hvedvig@foley.com)

The SEC has announced a very small window (no more than 60 days) in which to receive comments to this rule proposal. The Commission is under considerable pressure from investors and Congress to take action as promptly as possible. While the rule proposal is simply that — a proposal — manufacturers should expect much of the proposed package to become part of the agency's mandatory disclosure regime. Accordingly, manufacturing companies will likely need to consider and quantify the impact of environmental factors on both the upstream and downstream aspects of their business and the metrics by which to measure and report that impact.



## Highlights of the Proposed Rule on Corporate Environmental Impact

The proposed rule requires a public company to make more robust disclosures in its periodic reports filed with the SEC regarding its exposure to climate-related risks and its impact on the environment, focusing primarily on emission of greenhouse gases (carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, and nitrogen trifluoride). The proposed rule, which draws significantly from the guidance provided by the Task Force on Climate-Related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol (GHG Protocol), requires:

- Climate-related risk disclosures in registration statements under the Securities Act of 1933, as amended (the '33 Act) and in annual reports under the Securities Exchange Act of 1934, as amended (the '34 Act).
  - The proposed rule describes climate-related risks as both material physical risks (the risks posed by the impact of climate change such as climate-imposed damage or disruption to the operation of the business) or transition risks (the risks posed by transitioning to a lower-carbon economy and the attendant policy, reputation, legal, technological, and market-driven efforts to mitigate climate change).
- Disclosure of climate-related targets or goals and transition plans, if any, as well as the relevant baseline, metrics, and time expected to achieve the targets or goals.
- Reporting on Scope 1 emissions (direct GHG emissions from sources owned or controlled by the company) and Scope 2 emissions (emissions primarily resulting from the generation of electricity purchased and consumed by the company) by disaggregated greenhouse gases (the seven gases listed above), as well as in the aggregate and in terms of intensity. GHG intensity is the ratio between GHG emissions and economic value — the ratio of metric tons of carbon dioxide, for example, per unit of total revenue or production.
- Reporting on Scope 3 emissions if those emissions are material or if the company has set a GHG emissions reduction target or goal that includes its Scope 3 emissions. Scope 3 emissions include emissions resulting from a company's activities but generated from sources that are neither owned nor controlled by the company. These emissions include, for example, those associated with the production and transportation the company purchased from third parties, employee commuting, business travel, and the processing or use of the company's products by third parties.
  - The proposed rule includes an additional phase-in period for Scope 3 emissions disclosure, a safe harbor for Scope 3 emissions disclosure, and an exemption from Scope 3 emissions disclosure for a company meeting the definition of a smaller reporting company.
- Attestation reports for accelerated filers and large accelerated filers for Scope 1 and Scope 2 emissions.
  - The proposed rule allows such attestation reports to be provided by a party other than a registered public accounting firm.
- Inclusion of certain climate-related financial statement metrics and related disclosure in a note to the company's audited financial statements, including disaggregated climate-related impacts on existing financial statement line items. Disclosure would be required if climate risks affect 1% or more of the absolute value of the line item – meaning gains and losses are added, not netted, in reaching such disclosure determinations.
- Financial statement metrics will be subject to audit by an independently registered public accounting firm and considered within the scope of the company's Internal Controls Over Financial Reporting (ICFR).
- Disclosure of how a company identifies, assesses, and manages climate-related risks; how such risks are likely to affect its strategy, business model, and outlook; and whether such risks are likely to have a material impact on its business and consolidated financial statements over the short-, medium- or long-term.
- Disclosure of oversight and governance of climate-related risks by a company's board of directors and management. This oversight will require companies to design and test an array of disclosure and accounting controls needed to ensure the board and management are fully informed and to achieve compliance with the transparency obligations set forth in the proposed rule.



The proposed rule, therefore, will require public companies to develop and design new disclosures and accounting controls that will need to be mapped, tested, and audited.

### **The SEC's Prior Efforts to Enhance Climate-Related Disclosures**

On February 8, 2010, the SEC published extensive interpretive guidance regarding the extent to which existing disclosure requirements mandated significant and detailed discussion in periodic reports of the risks and costs of climate change that confront public companies. On March 4, 2021, the SEC announced that its Division of Enforcement had created a 22-person ESG task force to investigate and recommend enforcement proceedings in response to misleading statements regarding climate risks and failures by money managers to invest and maintain proper procedures, consistent with any professed commitment to prioritize ESG in deploying investor funds.

On March 15, 2021, Acting SEC Chair Allison Lee alluded to the rapid increase in investor interest in the impact of climate change on public companies and the hunger of the investment community for considerably more climate-related disclosure to inform its investment decisions. Acting Chair Lee stated that the SEC wanted more public input into its process of fashioning further guidance on disclosure in this space and solicited answers to 18 questions she believed should inform the SEC's efforts to enhance the disclosure of climate-related information in the periodic reports of public companies.

On April 19, 2021, the SEC's Division of Examinations published a Risk Alert describing observed shortcomings of money managers' actions given their professed commitment to investing with an emphasis on ESG. To further inform preparers of securities filings of the heightened expectations of the SEC, in September 2021 the SEC's Division of Corporation Finance published a form comment letter containing sample observations on the method and quality of climate-related disclosures of a hypothetical public company. Subsequent to releasing this form comment letter, the SEC sent similar comment letters to 38 issuers. The responses from these issuers, in turn, informed the crafting of the proposed rule.

Continuing the SEC's drumbeat, on December 7, 2021, Chairman Gensler predicted the SEC's anticipated climate-related risk rules would require public companies to measure the impact of their commitments to mitigating climate change and the challenges they face in responding to climate change. After the Commission signaled earlier in 2022 that its expected rule proposal might be delayed, Senator Elizabeth Warren wrote a letter to Chairman Gensler expressing her displeasure and characterizing the delays as "unwarranted and unacceptable, and violat[ive of] the commitment you made seven months ago [during Gensler's confirmation process]." On March 15, 2021, Senator Warren again commented on the SEC for its delay, stating "it's taken far too long for the SEC to take action."

### **Overarching Disclosures**

The proposed rule requires a public company to disclose information about its climate-related risks that are reasonably likely to have a material impact on its business, including consolidated financial statement metrics and GHG emissions metrics that are aimed at helping investors assess climate-related risks. More specifically, the proposed rule requires a public company to disclose:

- The oversight and governance of climate-related risks by a company's board and management; any board committees responsible for oversight of climate-related risks; whether any specific board member has climate-related risk expertise and, if so, a description of such expertise; and how frequently the board committees discuss climate-related risks.
- How any climate-related risks (physical risks or transition risks) identified by the company have had or are likely to have a material impact on the company's business and consolidated financial statements, which may become manifest over the short-, medium-, or long-term. Companies would be required to describe what they mean by short-, medium-, or long term. Companies also would be required to describe physical risks as either acute or chronic and would have to provide the ZIP code location of the properties or operations subject to physical risk.
- How any identified climate-related risks have affected, or are likely to affect, the company's strategy, business model, and outlook. Companies would need to disclose how these risks affect their consolidated



financial statements. If companies use carbon offsets or renewable energy credits in their emissions reduction strategies, they would need to disclose the short- and long-term risks associated with such offsets and credits. If companies use an internal carbon price to evaluate climate risk or determine climate strategy, they would be required to disclose how such a price was determined, including the price per metric ton of carbon dioxide. If companies describe the resilience of their business strategy, they would need to describe any analytical tools, such as scenario analyses, that they used to evaluate the impact of climate risks. Use of scenario analyses will require a robust description of the assumptions and parameters of such analyses.

- The company's processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the company's overall risk management system or processes.
- Reporting on the impact of climate-related events on the line items of the company's consolidated financial statements and related expenditures, and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities, including:
  - Severe weather events and other natural conditions;
  - Physical risks; and
  - Transition activities (including transition risks identified by the company).
- Scopes 1 and 2 GHG emissions and intensity, separately disclosed, and Scope 3 GHG emissions and intensity, if material, or if the company has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.
- The company's climate-related targets or goals and transition plan, if any. Any transition plan discussion would need to address relevant metrics and targets.

When responding to any of the proposed rule's provisions concerning governance, strategy, and risk management, however, a company may also disclose information concerning any identified climate-related opportunities.

### **Specific GHG Disclosures**

Under the proposed rule, all companies must disclose Scope 1 emissions, which are direct GHG emissions that occur from sources owned or controlled by the





company. In addition, all companies must disclose Scope 2 emissions, which are emissions primarily resulting from the generation of electricity purchased and consumed by the company. Companies must disclose both Scope 1 and Scope 2 emissions as disaggregated constituent greenhouse gases and in the aggregate, including in terms of intensity. The SEC reasoned that by requiring disaggregated data, investors could gain actionable information regarding the relative risks to the company posed by each constituent greenhouse gas in addition to the risks posed by its total GHG emissions by scope.

Scope 3 emissions are indirect emissions not accounted for in Scope 2 emissions, meaning emissions that are a consequence of the company's activities but are generated from sources that are neither owned nor controlled by the company, such as suppliers, vendors, and customers. Scope 3 emissions are required to be disclosed if those emissions are material or if the company has set a GHG emissions reduction target or goal that includes its Scope 3 emissions. The proposed rule includes a phase-in period for Scope 3 emissions disclosure, a safe harbor for Scope 3 emissions disclosure, and an exemption from the disclosure requirement for a company meeting the definition of a smaller reporting company.

In addition to the aggregate emissions of GHG, the proposed rule requires disclosure of the sum of Scope 1 and 2 emissions in terms of GHG intensity. For companies reporting Scope 3 emissions, they must also disclose a separate GHG intensity for those emissions.

### **Liability for Non-Compliance**

The proposed rule requires companies to file, rather than furnish, climate-related disclosures. Thus, the disclosures are subject to potential liability under Section 11 of the '33 Act and Section 18 of the '34 Act. The exception would be for disclosures furnished on Form 6-K, as disclosures on Form 6-K are treated as furnished under the SEC's foreign private issuer disclosure system.

Scope 3 emissions disclosure also would enjoy a safe harbor from certain forms of liability. The SEC recognizes that information about Scope 3 emissions is outside a company's control and may be difficult for a company to verify, such that a company will need to rely on estimates and assumptions. The proposed rule, as a result, provides that a Scope 3 emissions disclosure would not be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

In the commentary to the proposed rule, the SEC notes that the existing safe harbor for forward-looking statements under the '33 Act and the '34 Act would be available for forward-looking climate-related disclosures. It should be noted, however, that the safe harbor protections for forward-looking statements under the Private Securities Litigation Reform Act of 1995 do not apply to companies that are filing an IPO registration statement and are otherwise subject to the proposed rule's climate-related disclosure requirements.



## Timing

The comment period for the proposed rule ends on the date that is 30 days after the date of publication in the Federal Register or May 20, 2022, whichever period is longer. May 20, 2022, which is 60 days after the SEC released the proposed rule, is in keeping with the SEC's current practice of providing relatively short comment periods.

The proposed rule outlines a phase-in process for all companies, with the final compliance date dependent on the company's filer status as a large accelerated filer, accelerated or non-accelerated filer, or smaller reporting company, and the content of the item of disclosure. If the effective date of the proposed rule occurs in December 2022 and the company has a December 31 fiscal year-end, the compliance date for the proposed rule disclosures in annual reports, other than the Scope 3 emissions disclosures,<sup>1</sup> would be:

- For large accelerated filers, fiscal year 2023 (filed in 2024);
- For accelerated and non-accelerated filers, fiscal year 2024 (filed in 2025); and
- For smaller reporting companies, fiscal year 2025 (filed in 2026).

Large accelerated filers and accelerated filers would have additional time to transition to the attestation requirements for Scope 1 and 2 emissions. They would have one fiscal year to provide limited assurance and two additional fiscal years to providing reasonable assurance.

### For large accelerated filers:

- Initial Disclosures – fiscal year 2023 (filed in 2024);
- Limited Assurance – fiscal year 2024 (filed 2025); and
- Reasonable Assurance – fiscal year 2026 (file 2027).

### For accelerated filers:

- Initial Disclosures – fiscal year 2024 (filed in 2025);
- Limited Assurance – fiscal year 2025 (filed 2026); and
- Reasonable Assurance – fiscal year 2027 (file 2028).

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1. Companies subject to the Scope 3 emissions disclosure requirements would have one additional year to comply with those disclosure requirements.

Filers that have a non-calendar year fiscal year-end that results in their 2023 or 2024 fiscal year commencing before the compliance dates of the proposed rule would not be required to comply with the GHG disclosure requirements until the following fiscal year.

## Other Observations and Closing Thoughts

The proposed rule refers to materiality in a number of instances in connection with the disclosures that should be made. Although there was speculation prior to the release of the proposed rule that the SEC might change the traditional definition of materiality for purposes of climate-related disclosures, the SEC did not do so.

In recognition of potential legal challenges to the proposed rule, the SEC has made the argument in the release of the proposed rule that (1) the proposed disclosures are an outgrowth of current investor demand; (2) many issuers, namely large accelerated filers, are fairly far along in reporting on climate-related matters and; (3) the proposed rule would eventually simplify matters for companies and investors by providing a single reporting standard, in contrast to the multiple reporting standards and non-uniform reporting under such standards. Whether smaller reporting companies would be able to ramp up in a timely and cost-effective manner to comply with the proposed rule is an open question. The SEC acknowledges in the Incremental and Aggregate Burden and Cost Estimates section of the release for the proposed rule that the costs of implementing the proposed rule are very significant, but what is not said is that the cost of not adopting the proposed rule may be more significant.

If adopted, the proposed rule would require publicly-held manufacturers to significantly expand their investment in the development, design, maintenance, testing, and auditing of disclosure and accounting controls. This investment likely would include taking on additional personnel; training; development of software applications; new procedures governing the capture, assessment, and disclosure of the climate-related information discussed by the SEC; and attestation designed to assess the effectiveness of the new controls. The quality of that investment, however, will go a long way in minimizing the adverse consequences of any subsequent suggestion of non-compliance.

# Human Rights Compliance in Supply Chains

Companies in the manufacturing industry who wish to address the “S” in ESG can start by addressing human rights compliance in their supply chains. While some firms are far along in this journey, many are just getting started. For those in the latter category, we recommend that you follow these initial steps: (1) conduct a supply chain human rights risk assessment, (2) conduct human rights compliance due diligence on high-risk suppliers, (3) add appropriate human rights compliance language to your supply agreements, and (4) develop a human rights monitoring and auditing program. Proactively taking these steps now is all the more important, considering the current strain on supply chains due to global events, component shortages, and ever-increasing regulatory and enforcement scrutiny.

## 1. Risk Assessment

To begin, compile a list of your company’s 20 largest suppliers and organize them by location, the type of goods they supply to you, and the cost. Next build a basic, but reasonable, risk heat-map, which assesses the likelihood of a human rights violation and the adverse impact such a violation could have on the business. Doing so allows you to identify those suppliers who might expose your company to legal liability or reputational damage associated with human rights violations. The factors described below are a good place to start, although others may be relevant depending on the nature of your business.

Begin with a jurisdictional analysis. Countries that pose a higher risk of tolerating child or forced labor can be fairly easily identified using public information:

[\(See Chart 1\)](#)

Next, look at the industry in which your supplier operates. What type of products are you purchasing from them, and what are the history and risks of human rights violations historically associated with that industry?

[\(See Chart 2\)](#)



### AUTHORS

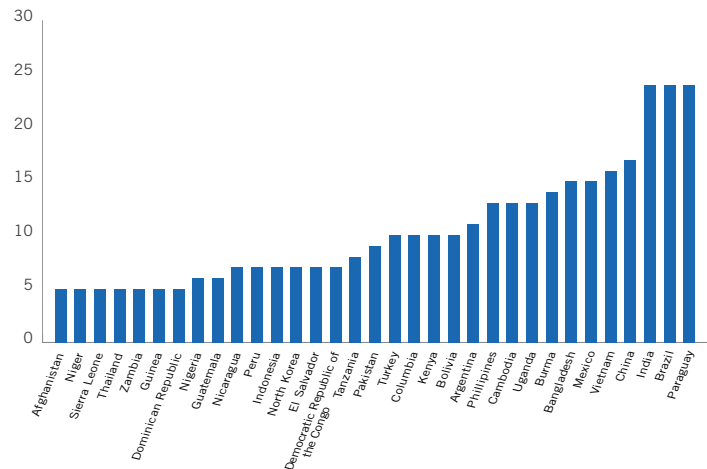
David Simon | dsimon@foley.com

Rohan Virginkar | rvirginkar@foley.com

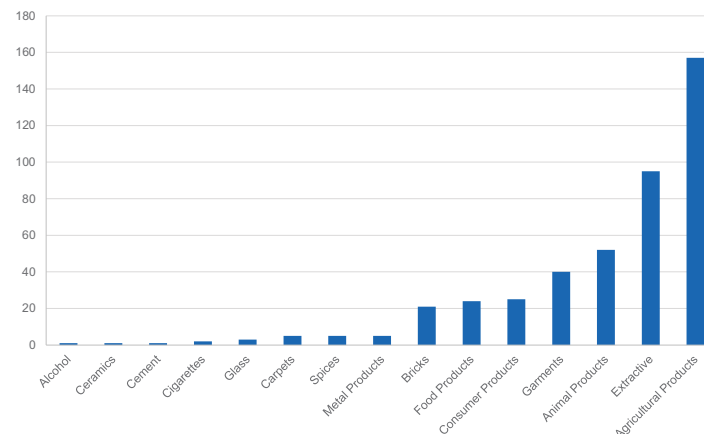
David Levintow | dlevintow@foley.com

John Turlais | jturlais@foley.com

**Chart 1: Number of Goods by Country Produced by Child or Forced Labor**

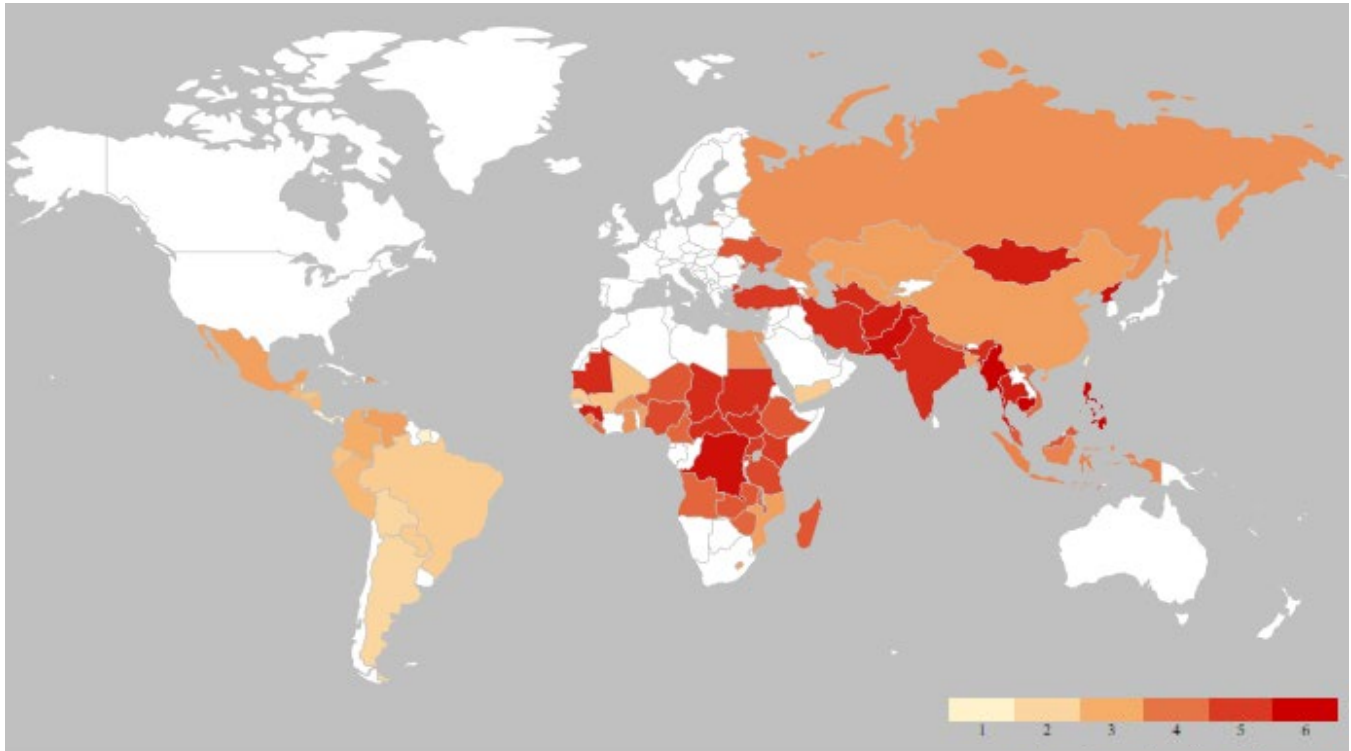


**Chart 2: Count of Goods Produced by Child or Forced Labor**





To visualize this data as a risk heat-map, we combined these two criteria, and blended the data with Global Slavery Index data on prevalence of modern slavery. The resulting map is below:



## 2. Due Diligence

Once high-risk suppliers have been identified, you should conduct some compliance-focused due diligence on them to further probe the risk of human rights violations in your supply chain. Here, many manufacturing companies will already have a serviceable template from which to start: the process used to evaluate third-party intermediaries for purposes of complying with anti-corruption laws, such as the Foreign Corrupt Practices Act (FCPA) or U.K. Bribery Act (2010). The process for identifying forced and child labor risks in a company's supply chain can be similar, even though the substance and context are different. Basic due diligence tools include:

**Human Rights Compliance Questionnaires:** Requiring suppliers to complete a detailed questionnaire is one way to obtain information helpful in assessing the likelihood of human rights risks in your supply chain. Some model questions that can be used for most suppliers are included as:

- Do you have a human rights compliance policy?
- What specific policies or practices are in place to address human rights risks (including modern slavery, illegal child labor, and human trafficking)?
- How do you assess and/or manage risk associated with human rights issues?
- Who or what function is responsible for overseeing compliance, with policies addressing human rights issues?
- What procedures do you employ to check the ages and confirm the identities of your employees?
- Have you been the subject of any government investigation or audit relating to your labor practices?
- Have you been the subject of any fines or penalties from any government authority, relating to your labor practices?
- What, if any, due diligence do you perform on your suppliers or third parties to address human rights issues?

- Are your facilities located in countries with a reputation for human rights violations?
- Do you subcontract any manufacturing to entities located in countries with a reputation for human rights violations?
- Do you procure any product components from entities located in countries with a reputation for human rights violations?
- When contracting with third parties, do you include terms and conditions and other standard contractual provisions that address compliance with respect to human rights issues?
- How are instances of noncompliance with your compliance policies addressed?

**Reputational Report:** Commissioning a background report on higher-risk suppliers can enable you to vet answers provided in response to questionnaires as well as identify prior associations with human rights violations (or violators), government enforcement actions, or other issues or reports that adversely reflect on the supplier's reputation.

**Red Flag Follow-Up:** Investigating any red flags identified in either the questionnaire responses or the background report is a must. For example, a supplier might, without engaging in due diligence, purchase product components from manufacturers in countries with a reputation for human rights violations. Red flags such as these do not mean that you cannot work with the supplier; investigate the issues to determine

the appropriate way to proceed. Flags come in varying shades of red, and determining the appropriate response requires following up to better understand the facts and circumstances and, potentially, to engage in specific remediation.

### 3. Contractual Clauses

A lot of compliance starts and ends with contractual clauses, because these are sometimes the best (or only) leverage companies have with suppliers. We view proactive risk mitigation through thoughtful contracting as obviously necessary (though clearly not sufficient). Good contracts will address the following issues:

- Inclusion of appropriate representations and warranties that the supplier is abiding by all applicable human rights laws;
- Requirement that suppliers maintain or adopt reasonable and appropriate human rights compliance measures; and
- In appropriate circumstances, a requirement that the supplier permit periodic audits of relevant documents, records, obligations, and creation of audit rights.

The American Bar Association's Business Law Section has drafted a set of **Model Contract Clauses** to guard against human rights abuses in international supply chains. Manufacturers should review these provisions and consider inclusion of them when contracts with suppliers are renewed or when establishing relationships with new suppliers.





#### 4. Monitoring & Auditing Program

The last step is the most challenging. For a human rights compliance program to be taken seriously, it must include some form of continuous monitoring, supported by periodic audits. At a minimum, manufacturers should require high-risk suppliers to regularly certify compliance, reengage in due diligence of suppliers on a periodic basis, subject selected suppliers to periodic audits, and include training on relevant laws or company policies. Some hallmarks of a monitoring and evaluation program are detailed in the **UN's Guide to Supply Chain Sustainability**:

- **Supplier Self-Assessment:** Self-assessments, which can involve similar questions to those detailed in the questionnaire described in Section 2, can identify suppliers that have improved their human rights compliance practices, as well as those that may require additional scrutiny. At the least, self-assessments can reinforce, for suppliers, a company's expectations with regard to human rights compliance.
- **Facility Tour:** A visual inspection of a supplier's factory can identify instances of noncompliance.
- **Records Review:** This should involve review of compliance policies, health and safety records, and any subcontracts with suppliers.
- **Management Interview:** Understanding senior management's commitment to human rights compliance is critical to understanding any risk posed by a supplier.
- **Workforce Interviews:** While management may be best positioned to speak about the supplier's approach to compliance, the boots on the ground are often the best source to understand how that theory translates into practice (if it does).

Effective audits are expensive and time consuming. But here, too, companies can look to vendors for support, as quite a few now conduct ethical trade audits. Taken together, the foregoing four steps will jump-start your company's supply chain compliance program and position you well to manage and mitigate risk. The sooner, the better.



# Hot Topics in Consumer Product False Advertising Class Actions: An Increased Focus on Ethics, Sustainability, and Safety Claims

## Overview

The past 18 months have witnessed a steady increase in the filing of consumer class actions involving allegations of false or deceptive advertising related to consumer products. While such cases traditionally focused on product features or performance, more and more class actions challenge advertising describing the environmental, sustainability, and ethics practices of the consumer product manufacturers themselves. In addition, more plaintiffs are bringing false and deceptive advertising claims based on affirmative statements of product safety or a failure to disclose the presence of supposed harmful substances. This article discusses examples of recent cases that illustrate these trends.

## “Greenwashing” Suits

The rise in “conscious consumerism,” or the commitment to purchasing decisions that have a positive social, economic, and environmental impact,<sup>1</sup> has resulted in a number of consumer product manufacturers touting their products as “sustainable,” “ethical,” “environmentally friendly,” “green,” and “cruelty free.” But what happens when details emerge about purportedly unethical or unsustainable practices within these manufacturers’ supply chains? As the examples below illustrate, putative class action plaintiffs have been quick to challenge the manufacturer’s marketing claims about environmentally friendly actions, the sustainability of their products, and “cruelty-free” or ethical manufacturing processes.

1. <https://bschool.pepperdine.edu/blog/posts/conscious-consumerism.htm>



## AUTHORS

Jaikaran Singh | [jsingh@foley.com](mailto:jsingh@foley.com)

Charlie Niemann | [cniemann@foley.com](mailto:cniemann@foley.com)

- In *Lee v. Canada Goose US, Inc.*, the plaintiff alleged that the manufacturer’s representation that a coat had fur obtained through “ethical, sustainable, and humane sourcing” was misleading given the coat manufacturer’s use of leg traps and snares. Rejecting the manufacturer’s argument that the plaintiff’s “subjective views” regarding fur-trapping standards “do not render the Company’s statements misleading or deceptive,” the district court denied the motion to dismiss, reasoning that the allegations “support[ed] the reasonable inference” that the manufacturer’s “purported commitment to ‘ethical’ fur sourcing [was] misleading because [it] obtains fur from trappers who use allegedly inhumane leghold traps and snares.”<sup>2</sup> Although the court found that the complaint sufficiently alleged false advertising, the parties later stipulated to a voluntary dismissal (with prejudice) when it was discovered that the plaintiff never relied on the challenged product representation at time of purchase.
- In *Dwyer v. Allbirds, Inc.*, the plaintiff alleged that advertised figures relating to the average carbon footprint of a popular footwear and apparel company’s products were misleading because they failed to account for the larger environmental impact of wool production, thus “excluding almost half of wool’s environmental impact.” The complaint also alleged

2. *Lee v. Canada Goose US, Inc.*, No. 20 Civ. 9809 (VM); 2021 WL 2665955, at \*7 (S.D.N.Y. June 29, 2021).



that the manufacturer's wool supplier had not taken adequate measures to ensure that the "sheep live the good life," as claimed on the manufacturer's website. The manufacturer moved to dismiss, asserting that its carbon-footprint calculation was described accurately and that statements about sheep living "the good life" are too imprecise to form the basis for an actionable legal claim. In dismissing the complaint without leave to amend, the court held that it was not plausible for a reasonable consumer to think the carbon-footprint calculation was done in a way other than as described and that the challenged animal welfare statements were "classic puffery," intended to be humorous, not a factual claim.<sup>3</sup>

- A proposed class in *Marshall v. Red Lobster Mgmt. LLC* has accused a popular seafood restaurant chain of lying about the sustainability of its Maine lobster and farmed shrimp, saying the restaurant chain's suppliers use inhumane methods and environmentally damaging practices. The complaint includes causes of action under California's consumer protection statutes. Defendant's motion to dismiss is pending.<sup>4</sup>
- *Hanscom v. Reynolds Consumer Products LLC* involves consumer class claims challenging the marketing of recycling bags as "Perfect for All Your Recycling Needs" and "Designed to Handle All Types of Recyclables" as false and misleading because the bags themselves are not recyclable. Rather, the complaint alleges the bags contaminate the recyclable waste stream, decrease the recyclability of otherwise recyclable materials, and are not recyclable because they are made from low-density polyethylene ("LDPE") plastic. Citing the growing problem of unrecycled plastic waste, the complaint alleges that many consumers seek to purchase products that are either compostable or recyclable, and that defendants capitalized on consumers' demand for "green" products by falsely implying their "Recycling" bags are recyclable.<sup>5</sup>

3. *Dwyer v. Allbirds, Inc.*, No. 21 Civ. 05238, 2022 WL 1136799 (S.D.N.Y. April 18, 2022).

4. *Marshall v. Red Lobster Mgmt. LLC*, No. 21 Civ. 04786 (C.D. Cal. June 11, 2021).

5. *Hanscom v. Reynolds Consumer Products LLC*, No. 21 Civ. 03434 (N.D. Cal. May 7, 2021).

## False Advertising Challenges to Product Safety

Claims alleging false advertising as to the safety of products for failure to disclose alleged health risks reflect another trend seen in recent years. Some of these safety claims relate to the growing concern with Per- and polyfluoroalkyl substances ("PFAS"), nicknamed "forever chemicals" because they do not break down in the environment, and benzene, a carcinogenic chemical alleged to be present in dozens of sunscreen, after-sun products, and antiperspirants. Plaintiffs have also sued manufacturers of pet foods and cosmetic products for advertising claims about their quality and safety notwithstanding the presence of harmful ingredients. Below are examples of false advertising lawsuits stemming from marketing claims regarding product safety and the failure to disclose the presence of alleged harmful substances.

- Several of the largest cosmetics manufacturers face class action lawsuits alleging that they misled plaintiffs by failing to disclose the presence of PFAS in products. These suits include *Vega v. L'Oreal USA, Inc.*, *GMO Free USA v. Cover Girl Cosmetics*, and *Onaka v. Shiseido Americas Corp.* Each of these lawsuits alleges that advertising claims about



product safety and sustainability were false given PFAS' environmental toxicity and association with high cholesterol, thyroid disease, ulcerative colitis, and certain types of cancer. These complaints allege that, because the manufacturers failed to disclose the presence of PFAS, consumers were misled and deceived by the product labeling.<sup>6</sup>

- Following a study and FDA citizen petition filed by a self-proclaimed independent laboratory pharmacy, a number of plaintiffs filed lawsuits against manufacturers of sunscreen and aerosol body sprays based on alleged benzene contamination. These complaints allege that no reasonable consumer would expect to find any benzene, a known carcinogen and reproductive toxin, at levels above the limits set by FDA in consumer products. The large number of complaints filed in federal court led to consolidated Multi-District Litigation proceedings in the Southern District of Florida. Some defendants have entered into class-wide settlements of these claims.<sup>7</sup>
- Other benzene litigation remains ongoing, including a putative class action pending in the Southern District of Ohio alleging that Procter & Gamble “wrongfully advertised and sold ... Aerosol Antiperspirant Products without any labeling to indicate to consumers that these products may contain

benzene.”<sup>8</sup> Another class action lawsuit pending in the Northern District of Illinois alleges that Unilever failed to disclose the presence of unsafe level of benzene in its antiperspirant products, thereby misleading consumers who relied on Unilever's representations regarding product safety.<sup>9</sup> A motion to dismiss the complaint is currently pending.

- In *Weaver v. Champion Petfoods USA Inc.*, a pet food manufacturer's packaging touted its “biologically appropriate” dog food made with “fresh regional ingredients” prepared in their “award-winning kitchens”—“never outsourced.” Plaintiff alleged these claims were false and misleading because, according to plaintiff, there was a risk the dog food contained BPAs and pentobarbital. The trial court and Seventh Circuit were not persuaded, as it was “undisputed that humans and animals are commonly exposed to BPA, no BPA was added to the dog food, and the level of BPA purportedly in the dog food posed no health risks to dogs.” The mere risk that any small amount of BPA was present in the food did not render the product representations misleading to a reasonable consumer.<sup>10</sup>
- In *Goldfarb v. Burt's Bees, Inc.* the plaintiff brought suit challenging Burt's Bees' label claim that its dog shampoos and conditioners are “99.7% Natural,”

6. *These suits include GMO Free USA v. Cover Girl Cosmetic*, No. 2021 CA 004786 (D.C. Sup. Ct. Dec. 29, 2021); *Onaka v. Shiseido Americas Corp.*, No. 21 Civ. 10665 (S.D.N.Y. Dec. 14, 2021).

7. *In re Johnson & Johnson Aerosol Sunscreen Marketing, Sales Practices and Products Liability Litigation*, No. 21-md-03015, Dkt. 25 (S.D. Fla. Oct. 29, 2021).

8. *Bryski v. The Procter & Gamble Co.*, No. 22 Civ. 1929 (S.D. Ohio Nov. 4, 2021).

9. *Barnes v. Unilever United States Inc.*, No. 21 Civ. 06191, Dkt. 41 (N.D. Ill. Mar. 25, 2022).

10. *Weaver v. Champion Petfoods USA Inc.*, No. 18 Civ. 1996 (JPS) (E.D. Wisc. Dec. 18, 2018); 3 F.4th 927, 935 (7th Cir. 2021).





when in reality they allegedly contained synthetic chemicals that are harmful to pets. The complaint points to FTC guidance on the use of the term “natural” in advertising materials, asserting that consumers have the right to take manufacturers at their word when they claim a product is “100% natural.” Despite rumblings for years<sup>11</sup> that further regulatory or legislative guidance on the use of the term “natural” in advertising is needed, to date FDA has not provided a definitive definition.<sup>12</sup> The case was voluntarily dismissed within months of filing as the parties reached an out-of-court resolution.

- Based on a November 2021 report concluding that certain spices contained unsafe levels of arsenic, lead, and cadmium, plaintiffs filed a class action complaint against a spice manufacturer alleging it knowingly concealed the presence of heavy metals in its products. As support for their claims, Plaintiffs pointed to affirmative representations that the manufacturer made about the quality, safety, and integrity of the spice products, focusing on the company’s slogan: “The Taste You Trust.”<sup>13</sup> A motion to dismiss the complaint is currently pending.

## Conclusion

With increasing consumer interest in “environmentally friendly” and “ethically produced” products, as well as a greater awareness regarding product safety and ingredients used, manufacturers have employed marketing strategies seeking to address consumer demand and tastes. Given recent case trends, however, caution should be taken in making advertising claims regarding the company’s sustainability practices or on matters of product safety involving potential health risks. Consumer product manufacturers should review their labeling and advertising on these topics to avoid or minimize the risk of potential false advertising or failure to disclose claims. Although many of these types of statements have been regarded as non-actionable puffery or there may be no duty to disclose, it will be important to monitor these cases for further guidance from the courts as to whether these are short-lived liability theories or a long-term threat that is here to stay.

11. *E.g.*, HR 5017, introduced in November 2019, would have amended the FDA Act to define “natural” with a certain set of standards.

12. *Goldfarb v. Burt’s Bees, Inc.*, No. 21 Civ. 04904 (VM) (S.D.N.Y. June 3, 2021).

13. *Balistreri v. McCormick & Co.*, No. 22 Civ. 00349 (SVK) (N.D. Cal. Apr. 14, 2022).



# Flexible Strategies for Managing Uncertainty in Manufacturing Supply Chains

In 2022, manufacturers still face many of the same issues that bedeviled the industry throughout 2021, as well as a host of all-new challenges, including the impact of the war in Ukraine, labor shortages, and unprecedented inflation. Unfortunately, as with many aspects of pre-pandemic life, the relative stability in the global supply chain that industries enjoyed for many years is unlikely to be restored any time soon. Manufacturers and their suppliers must be agile to adapt to these new and continuing challenges.

This article highlights several key areas of focus for companies looking ahead, including seeking greater flexibility and risk sharing in pricing, warehousing/inventory, and managing freight costs. Among other strategies, companies should consider updating many of their traditional operational and contracting practices in order to enhance flexibility in a more unpredictable world. While the changing landscape presents challenges, it also presents opportunities for growth. The companies that adapt quickly will be the companies that are best positioned to thrive going forward.



## AUTHORS

Vanessa Miller | [vmiller@foley.com](mailto:vmiller@foley.com)

Nicholas Ellis | [nellis@foley.com](mailto:nellis@foley.com)

## 1. Manufacturing Supply Chain Challenges in 2022

For many companies, and for manufacturers in particular, 2021 was a year defined by shortages, increased costs, and other unprecedented supply chain challenges. The lockdowns of 2020 quickly gave way to shortages of many raw materials and components, as supply could not keep up with surging demand. While the global shortage of semiconductors may be the most well publicized of these issues, many companies also faced difficulty in obtaining other materials, including lumber, steel, resin, and foam. In keeping with the Law of Supply and Demand, these shortages quickly turned into rapidly escalating costs for many companies, with hefty price increases that were not contemplated in the seller's original quotations and, in many cases, are not expressly covered by their long-term supply contracts.





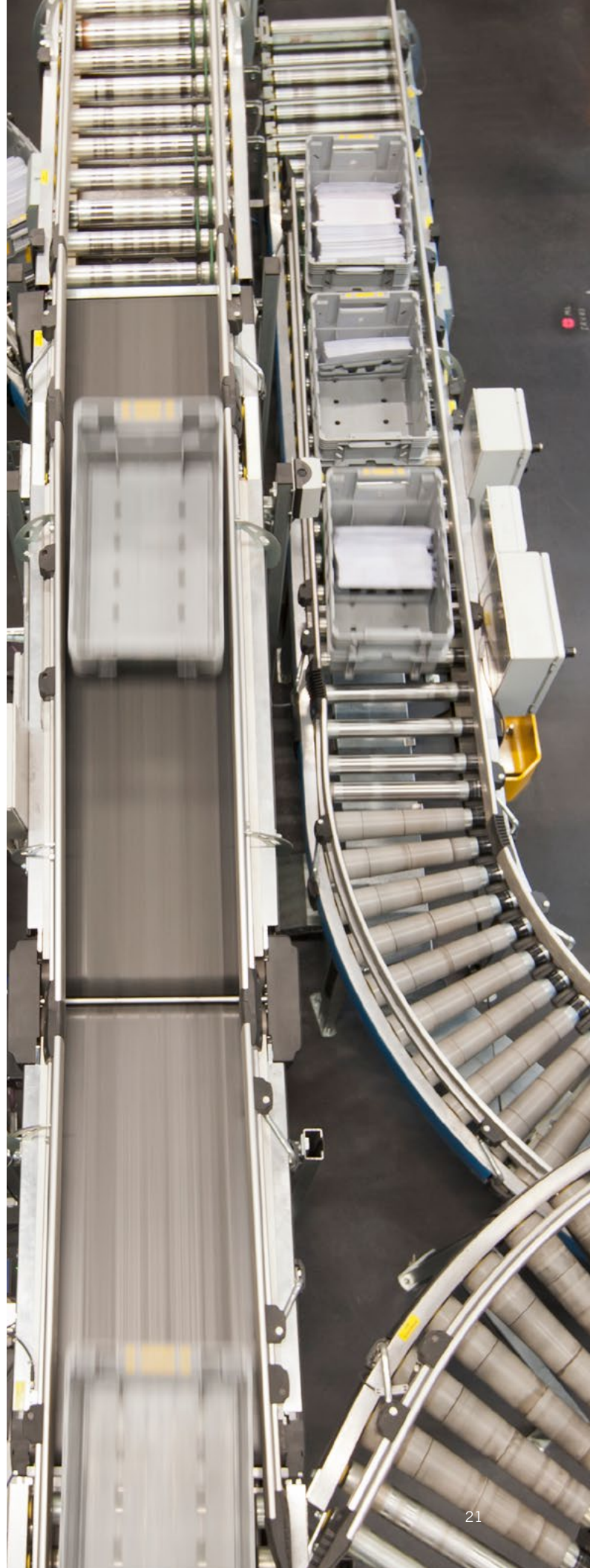
In addition to difficulty obtaining materials, many companies faced significant operational and logistical hurdles. They encountered and continue to face difficulties in obtaining sufficient labor to keep their operations running at full capacity. Companies also had to contend with myriad logistical challenges, including port delays, the Suez Canal blockage, a dearth of containers, a scarcity of truck drivers, and massively increased costs for shipping. The cost of shipping containers from Asia to the United States soared, increasing over 500% as compared to just a year earlier.<sup>1</sup> Companies also faced surging labor costs. Under the burden of these significant challenges, the manufacturing supply chain exchanged a fresh wave of force majeure declarations and notices of commercial impracticability. Unlike the situation in 2020, when many manufacturers shut down in unison, such declarations often were the subject of significant disputes as parties wrangled over responsibility for costs to maintain operations and timely deliver products.

Compounding these difficulties, many companies' efforts to manage their supply chains were further complicated by unpredictable (or unmanageable) demand. Some companies were caught by surprise when demand for their goods surged in the face of COVID-19 instead of falling off, as the worst predictions of economic devastation largely were avoided. This has led to significant misalignments of demand and capacity throughout the manufacturing supply chain. Some manufacturers have been left struggling to meet demand from their customers, while others have seen their sales drop, or get deferred, as their buyers have to reduce production due to shortages or delays in obtaining other components needed to manufacture the final products. In a global manufacturing system that for decades had been predicated on ever-increasing efficiency — having exactly the right goods in exactly the right place at exactly the time they were needed — these problems all have contributed to significant inefficiencies that are now contributing to surging inflation.

Unfortunately, 2022 already has proven to be another difficult year for many manufacturers. Analysts predict that the raw material shortages and other supply chain disruptions will continue into at least 2023,

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1. <https://www.reuters.com/business/china-us-container-shipment-rates-sail-past-20000-record-2021-08-05/>





even if there are some signs of gradual improvement.<sup>2</sup> COVID-19 remains an ongoing threat to disrupt supply chains. While there appears to be little appetite for a return-to-lockdowns in the United States, lockdowns remain a possibility in many other countries. In particular, China has hewed closely to a “zero-COVID” strategy and recently re-imposed lockdowns in a number of cities. Faced with an expanding outbreak of the Omicron sub-variant BA.2 in March and April, China imposed lockdowns in Shanghai, a city of 26 million people.<sup>3</sup> As a result, many manufacturers were forced to shut their production facilities or only managed to maintain production through drastic measures of having their work force effectively live at the factory. Continued spread of the outbreak may threaten production in other regions.

2. <https://www.supplychaindive.com/news/shortages-2022-outlook-supply-semiconductors-aluminum-food/617537/>

3. <https://www.reuters.com/world/china/shanghai-lockdown-deepens-after-new-surge-asymptomatic-cases-2022-04-05/>

On top of the continuing challenges posed by COVID-19 and existing material shortages, many manufacturers must now contend with the impact of the war in Ukraine. Companies with operations in Ukraine have faced the obvious and significant disruptions that come from an ongoing armed conflict. Companies with operations in Russia, or whose customer base or supply chain are tied to Russia, have been left scrambling as they comply with both the legal and ethical hurdles to continuing such relationships, including the ever-expanding list of sanctions. Even those companies whose operations are not tied directly to Ukraine or Russia are being affected, as the war and sanctions affect both the prices and availability of numerous commodities, including for example energy, wheat, neon, and aluminum. These disruptions and shortages (and the next disruption around the corner) are likely to continue causing headaches and financial uncertainty for manufacturers and will continue to drive up costs.





## 2. Strategies for Approaching the Changing Circumstances in the Global Supply Chain

For most of the last two years, many manufacturers have operated in some form of crisis management mode as they waited for the return to “normal.” Unfortunately, it is rapidly becoming apparent (to the extent it was not already apparent) that there will not be a return to the conditions that existed before the pandemic any time soon. COVID-19 will be with us, in one form or another, for the foreseeable future and the fallout from the war in Ukraine (including many of the sanctions imposed on Russia) is likely to continue. The era of minimal inflation that has prevailed in much of the world for the last decade appears to be over. For these and a variety of other reasons, companies likely face a period of greater instability and volatility in the global supply chain. So how can companies shift out of crisis management mode and adapt their business practices to survive, and even thrive, in the new environment? This article presents four key strategies that companies should consider, from the contracting stage through operations.

### A. Focus on pricing provisions and parameters

**triggering pricing relief** — For many years, in many segments of the manufacturing industry, long-term contracts at a fixed price have been the standard practice. In some cases, contracts may even require that a supplier provide annual price *reductions* (year-over-year costs savings or priceways). Provisions allowing a supplier to increase prices are relatively rare, with the exception of contracts for certain raw-material-intensive components. Both buyers and sellers alike, having lived through repeated cycles of spikes and declines in raw material pricing, recognized that long-term fixed price contracts for such components often proved to be untenable and utilized various forms of indexing or other flexible pricing for such components. In the current environment, with inflation and significant pricing volatility, companies are rethinking the traditional structure for supply contracts. Long-term contracts at a fixed or even declining price may no longer be practical. As has been the case in the past with raw material intensive components, companies should focus on implementing greater pricing flexibility into their contracts to account for changing costs, whether through some form of defined indexing, a periodic opportunity to renegotiate and market test, or other creative approaches.

**B. Warehousing and inventory banks** — For decades the traditional model for many manufacturing companies has been lean, just-in-time (JIT) inventory management, as companies have maintained only minimal levels of inventory. This was historically an incredibly efficient model — as long as everything was running smoothly and on time. However, as the pandemic and supply chain issues have laid bare over the last two years, once all of the proverbial “fat” has been stripped out of the system, there has been nothing left to cushion any shock to the system. Buyers and sellers both must now weigh the potential benefits of lean inventory against the risks posed by a supply chain that is far less stable and predictable than it was two years ago. Many companies have incurred significant costs for expedited freight, overtime, shutdowns, and other expenses that have far outstripped any savings and efficiencies realized from trying to maintain a lean inventory. As a result, many companies are looking at ways to mitigate these risks. In addition to looking at re-shoring and shortening supply chains (which primarily are long-term strategies with little capacity for short-term relief), many companies are rethinking their inventory models and moving to implement warehousing and larger inventory banks as a shield against shortages and disruptions. While this approach can be an effective strategy, it is not without its own added costs. Companies must think carefully when implementing such a strategy (either on their own initiative or at the request of their customers) to ensure that the costs are properly apportioned and accounted for.

**C. Stress-testing, dual sourcing, and contingency planning** — In many industries, the drive toward minimizing cost, as well as the expense associated with qualifying a new supplier, have driven a trend toward single sourcing material and component suppliers. In the new, less-predictable world of the global supply chain, companies that have not done so already should review their supply chains to understand where potential risks exist and whether a single-source strategy still makes sense. This often requires digging into the details and understanding where all levels of the supply chain are sourced. For example, a company purchasing components from two separate suppliers, one of which is located nearby, may feel that it has



mitigated its risk. However, if both of its direct suppliers are obtaining 100% of their raw material from the same sub-supplier, the company still is exposed to risk based on the sole source. Even if companies do not actively dual source components, it is prudent to have a contingency plan and understand what alternative sources are available if necessary, and how quickly a new supplier can be engaged, in the event of a disruption to the current supplier.

**D. Shifting risk for freight costs** — For many companies, freight costs have taken on outsized significance over the course of the last two years, both due to increased need for expedited freight and to rapidly increased costs (and delays) for ordinary shipping. Traditionally many buyers have treated most shipping costs, including costs for expedited freight (even in cases of force majeure and commercial impracticability) and costs to ship components from lower-tier companies, as something for which their suppliers are responsible. However, many companies are questioning this structure and pushing back. Numerous companies have struggled with increased costs for shipping,

particularly those needing to obtain components from Asia. As discussed above with respect to pricing and costs more generally, companies should look for ways in which to share some of the burden and risk of these costs with their customers. Many companies also have struggled with a need for frequent (and for some periods, near constant) expedited freight in order to compensate for delays in the supply chain. As most companies know, costs for expedited freight can rapidly become exorbitant and threaten to surpass their profit margins on a program for an entire year or even longer. In recent years, buyers and sellers have treated costs for expedited freight as a zero-sum game, with buyers demanding that their suppliers pay the entire costs for expedites and suppliers often balking and refusing to pay such costs (even if otherwise obligated to do so under the applicable contract/law). Given that the challenges in the supply chain show no sign of alleviating soon, companies should consider possible new approaches in which both buyers and sellers each share some of the risk for expedited freight arising out of issues that are outside of their control.



### 3. Conclusion

The global supply chain has changed, and manufacturers must adapt to the new circumstances. The challenges faced by manufacturers in 2021 have continued into 2022, and many show no signs of abating. If manufacturers have learned anything from the last 18 months, it is to expect the unexpected and apply the “lessons learned” to navigate challenges

going forward. These challenges will require companies to reevaluate many of their contracting and operations, including their approach to managing the risks inherent in pricing, warehousing/inventory, and freight costs. More volatility in the supply chain requires that contracts be more flexible in order to allow for a bend-but-don't-break approach to resolving challenges as they arise.



# Industry 4.0 Heralds a Sea Change in IP Protection for Manufacturers

Smart Manufacturing, often referred to as “Industry 4.0,” refers to the fusion of digital manufacturing techniques with traditional manufacturing techniques. While there are many technologies that can be identified as playing a part in smart manufacturing, this article will focus on four that are currently receiving attention: cloud adoption, the Internet of Things (IoT), machine learning and artificial intelligence, and additive manufacturing. Successful deployment of smart manufacturing technologies can lead to faster, more efficient production that is also safer for factory floor workers. Implementation of these technologies also poses intellectual property challenges to which manufacturers may not be accustomed but that, if managed appropriately, promise great rewards.

## Cloud Adoption

Cloud computing refers to the distribution of data and applications over multiple locations, allowing on-demand access to the data and applications from several locations by users. As with many other industries, manufacturers are adopting cloud-based computing techniques to enable agile manufacturing and provide real-time data to the production floor. For example, capacity loading information from several production machines, perhaps located at several different geographic locations, can be shared to a cloud so that it is accessible by a distribution unit in real time. This enables the distribution of work to production machines in an efficient manner.

Market Research Future forecasts \$111.9 billion of cloud computing investment in the manufacturing sector. Manufacturers contemplating moving their production processes to the cloud should take a moment to assess whether the new process is patentable. While it may seem counterintuitive that moving an existing manufacturing process to a cloud-



AUTHOR

John Lanza | [jlanza@foley.com](mailto:jlanza@foley.com)

based platform would yield patentable subject matter, a brief survey of issued patents shows that changes necessary to modify a process so that it executes properly on a cloud-based platform can, indeed, lead to patentable subject matter. Moreover, newly-generated software routines to implement the cloud-based process are likely the subject of copyright, and protection for such materials should be evaluated.

A related issue for manufacturers moving to cloud-based platforms is the security of their systems and data. Cloud-based systems, because of their inherent interconnectedness with other systems, are susceptible to attack. In 2020, targeted ransomware emerged as a pervasive cyber threat to manufacturing. Such attacks are expected to increase as manufacturing companies adopt increasingly digital profiles. Companies adapting smart manufacturing technology need to protect their intellectual property and the resultant data that is generated. Data breach remediation is also likely to be important; information-stealing attacks make up about a third of cyberattacks on manufacturing concerns, with one in five companies successfully compromised.

## The Internet of Things

The Internet of Things (IoT) refers to inclusion of sensors, processing ability, and communication technology in physical devices. IoT has already begun to change how we view devices in our homes; smart TVs, smart thermostats, and smart appliances are seemingly ubiquitous. That perspective change is



coming to manufacturing as well, as several companies race to release a universal operating system for all IoT devices. Beyond the obvious changes to the manufacturing floor itself, manufacturers should be aware of two foundational changes IoT will make to their business: IoT will make protection of trade secrets increasingly difficult, and IoT will radically change the relationship a manufacturer has with the end consumer.

Traditionally, many aspects of a manufacturing line were protected as trade secrets. For example, the exact setting used for a machine to process raw material into the desired result might be something known only to the individuals tasked with running that machine. In the IoT world, that machine is interconnected with other machines, and that interconnectedness makes it a potential target for attack. Successfully compromised machines may give up their settings, preferences, and other secrets that make a manufacturing line “special.” So again, cybersecurity and data management will need to be priorities, not afterthoughts, in the factory of the future.

Looking outwardly, IoT radically changes the traditional relationship a manufacturer has with the end consumer, as it allows the manufacturer to have access to data regarding use of its end products. While collection of

actual data on consumer usage is a fantastic benefit for manufacturers, it comes with obligations surrounding both the collection of that data and securing the data after it has been collected. Provided that the data collected from end users is done in a transparent, privacy-responsible manner, that data represents a commercial asset that may ultimately prove more valuable than the original business.

### **Machine Learning and Artificial Intelligence**

The terms “machine learning” and “AI” are usually used to refer to techniques to enable machines to think like human beings. Applications of these techniques in manufacturing can include predictive maintenance, predictive quality and yield, digital twinning, generative design, energy consumption forecasting, and supply chain management. This area of technology may represent the largest opportunity for manufacturers to develop and maintain trade secrets relating to their operations. Identification of specific algorithms and the inputs provided to those algorithms to produce a desired result will differ between manufacturers, and a manufacturer that hits on a constellation of choices that results in superior performance will likely want to keep that from others in the field.





## Additive Manufacturing

Additive manufacturing, sometimes referred to as “3-D printing,” continues to attract interest and venture capital money despite the recent decline in the consumer market. Additive manufacturing allows lighter, stronger alloys to be used instead of traditional materials. It also enables a more efficient supply chain in which parts are manufactured when and where they are needed, rather than being manufactured in one place and shipped to another.

Although some recent developments point to a future in which large, complex items such as entire vehicles can be printed, most current use cases for this technology are to produce parts or subsystems for use in larger systems. The ability to use additive printing technology to manufacture machine parts requires manufacturers to be cognizant of the patent law doctrine of repair and reconstruction, which distinguishes between permissible repair of a patented article and impermissible reconstruction of a patented article, the latter of which is patent infringement. Manufacturers of larger systems will likely want to consult with patent counsel to ensure that their patent coverage is as robust as possible. Similarly, manufacturers of smaller components may require more extensive indemnity provisions in service contracts to shift the risk of patent infringement back to the customer.

Each part manufactured by 3-D printing is represented as a data file that is used by the printer to manufacture the desired object. Manufacturers will want to consider to what extent their data files can be protected by copyright, allowing them to control the ultimate manufacture of the object represented by the data file.

Finally, manufacturers may find themselves able to protect their printing activities using trademark protection. If, for example, a manufacturer has a specific process that allows them to 3-D print a certain material, or finds that objects printed using their process have superior characteristics to parts printed using other processes, that manufacturer may wish to develop a brand strategy around the process, e.g., Printed Using Magic™.

Smart manufacturing technology holds great promise for manufacturers while posing intellectual property issues with which many traditional manufacturers may be unfamiliar. Manufacturers that are able to identify those issues and capitalize on the opportunities they present will have the advantage in the shift to Industry 4.0.



# Manufacturing Employers Face Significant Labor Challenges in 2022

As employee retention issues and the “great resignation” make headlines, the manufacturing industry not only feels the pressure of a tight labor market in 2022, but also faces additional labor challenges. Despite signs earlier in the year that the COVID pandemic was waning, it continues to impact employers’ ability to remain fully staffed. Employers continue to face a changing and complex landscape with respect to continued remote work, labor shortages, and COVID-protocol-related accommodation requests. However, COVID matters are not the only key issues facing employers in the manufacturing industry this year. Changes to the National Labor Relations Board (NLRB or Board) and its general counsel in 2021 mean that unionized and nonunionized employers will face challenges in the traditional labor arena as well.

## 1. COVID, COVID, COVID — As Cases Begin to Increase Again, Employment Related Challenges Continue in 2022

### A. Remote Workforce Issues

Through the surges and slowdowns of COVID cases during the course of the pandemic, one pandemic-related change seems here to stay: a greater number of workers are working remotely. While some businesses are encouraging workers to come back to the office, others have enhanced remote work opportunities and face the challenges associated with a fully or partially remote workforce. Employers should take care to consider the legal implications of this change. If an employer now has employees working remotely in states where it previously did not have operations, there may be tax and other implications. Generally the laws of the state where an employee works will govern the employee’s employment. If employees are working in a new state or locality, employers should ensure



### AUTHORS

Dan Kaplan | [dkaplan@foley.com](mailto:dkaplan@foley.com)

Jeff Kopp | [jkopp@foley.com](mailto:jkopp@foley.com)

Felicia O’Connor | [foconnor@foley.com](mailto:foconnor@foley.com)

they are up-to-date on and mindful of those state and local laws that may differ from other locations where the employer operates. Are there local sick leave laws? Changes to enforcement of non-compete agreements? Requirements for reimbursement of expenses? Careful consideration of local employment laws and regulations can prevent costly missteps.

### B. Labor Shortage Pain — Difficulties in Hiring and Retention

Many employers are also currently facing an extreme labor shortage that has not only impacted hiring, but also retention of employees. In order to entice applicants and encourage employees to remain with the company, many manufacturing employers have increased financial and other incentives. Signing bonuses, attendance bonuses, and other financial incentives can be an effective means to recruit and retain talent. In doing so, manufacturing employers (who often have a large number of non-exempt workers) should be knowledgeable of the various wage-and-hour requirements to avoid any risk of unpaid wage or other claims. Employers should carefully consider whether the incentives they implement should be factored into the regular rate when calculating overtime. Likewise, employers should ensure that such incentives are consistently and fairly implemented.

### C. Accommodation Requests for COVID Protocols

Since the outset of the pandemic, employers have had to contend with various requests for accommodation relating to COVID protocols, whether related to mask requirements, vaccine mandates, or leave issues.

As an initial matter, employers should be aware that COVID can be a disability under the ADA, depending on the employee's symptoms. If an employee requests leave for COVID-related symptoms, beyond what is typically granted by company policy, employers should involve legal counsel to determine on a case-by-case basis whether it may be considered a disability that would require the company to engage in the interactive process.

Even if an employee does not test positive for COVID, employers may receive requests for accommodation due to a disability or religion that prohibits the employees from complying with COVID-related protocols. Many employers are familiar with this issue if they have a mask policy or vaccine policy. Employers should engage in the interactive process in such cases, in order to determine whether a reasonable accommodation can be granted that does not impose an undue burden on the company.

To the extent employers are permitting some employees to work from home, it is wise to make sure that decisions are made on a consistent basis

and are based on the employees' job duties. In a manufacturing environment, where at least some portion of the employee population likely has to be physically present in the workplace, remote-work decisions based on concrete job requirements will help to avoid future claims of unfair treatment.

### 2. Increased Union Activity to be Fueled by Changes to NLRB Standards and Priorities

COVID-related matters are not the only key issues facing employers in the manufacturing industry in "the coming year. We have already seen some diversions from the Trump-era labor board. As such, changes to NLRB standards and priorities will continue to affect unionized and nonunionized employers through 2022 and beyond.

In a striking example of the coming changes in the traditional labor space, on April 7, 2022, NLRB General Counsel Abruzzo issued GC-Memo 22-04, which describes her position with respect to employers' so-called "captive audience meetings": mandatory meetings held by the employer in which it gives its position regarding union organizing. The meetings have long been permitted under Board interpretation of the NLRA. Abruzzo's position, as described in the memo, would represent a dramatic shift in longstanding Board precedent. Abruzzo's position is that the meetings "inherently involve an







unlawful threat that employees will be disciplined or suffer other reprisals if they exercise their protected right not to listen to such speech.” She plans to urge the Board to reconsider its precedent and find mandatory meetings of this sort unlawful, because she believes the current precedent “is at odds with fundamental labor-law principles, our statutory language, and our congressional mandate.” The meetings have historically been an important tool for employers to get their message out to employees during a union-organizing campaign. If the Board does, in fact, overturn the precedent, employers will be challenged to find other ways to communicate with employees during a union campaign that are permitted under the NLRA.

Last year, on July 22, 2021, NLRB General Counsel Jennifer Abruzzo issued her first memo, which set her agenda and priorities for her four-year term. In addition, with various terms expiring and resultant Democratic nominations submitted for consideration, the Board itself has also changed from a Republican to a Democratic majority, led by Chairman Lauren McFerran. Not surprisingly, the memo and Democratic majority on the Board mark a significant change in priorities from the Trump-era NLRB to a more union- and employee-friendly stance. The following potential changes in standards and priorities of the NLRB are anticipated:

#### **A. Closer Scrutiny Regarding Employee Handbooks**

The NLRB is likely to increase scrutiny of employee handbook provisions that may be construed to restrict activities protected under Section 7 of the National Labor Relations Act (NLRA). Under the Trump-era Board, the NLRB had adopted the Boeing test with respect to employee handbooks. This test assessed a facially neutral handbook policy by balancing the alleged restrictions against the employer’s legitimate justifications for implementing the policy. The test was much more flexible and employer-friendly than the previous standard under the Lutheran Heritage case, which prohibited any handbook policy, including those that did not explicitly prohibit protected activities, if the rule could be “reasonably construed” by an employee to restrict such activities. At the time, the Board viewed such rules to have a chilling effect on protected activities and thus considered them a violation of the NLRA. The Boeing case is specifically referenced in the general counsel’s August 12, 2021 memo as a case “involving board doctrinal shifts” that upended prior precedent that “struck an appropriate balance between the rights of workers and the obligations of unions and employers.” This shows that the general counsel, and very likely the Board, are poised to return to the more employee-friendly Lutheran Heritage precedent. In anticipation of this

change, employers should review their handbooks for possibly problematic policies and be ready to change such policies if the Board issues a decision overruling the employer-friendly Boeing standard.

## **B. Possible Increased Application of *Weingarten* Rights**

As unionized employers know, *Weingarten* rights are the rights of represented employees to have union representation present when requested at an investigatory interview that may lead to discipline. Under current Board precedent, *Weingarten* rights only exist in a union environment. Specifically in 2017, the Board declined to extend *Weingarten* rights to an employee who was not represented by a union, but who had requested to have a co-worker present during a disciplinary interview. Over the years, the Board has changed its position on a few occasions regarding whether nonunion employees have the right to request representation during investigatory interviews. In 2000, the Board had held that nonunion employees *did* have a right to such representation but then changed its stance in 2004. The general counsel memo references the current Board precedent, which does not extend the right to nonunion employees, as an “area or initiative” bearing reexamination. Employers should watch for Board changes in this area and make sure its human resources employees and others conducting such interviews are up-to-date on any changes with respect to whether *nonunion* employees are entitled to representation upon request.

## **C. Access to Employer Property for Unionizing Purposes**

Another area where nonunionized employers should be aware of potential change in Board precedent is with respect to union organizers’ access to, and use of, the employer’s property. Under the current state of the law, pursuant to *Tobin Center for the Performing Arts*, an employer is permitted to exclude off-duty contractors from the non-public areas of its property even when they seek to engage in Section 7-protected activity unless the contractors (1) work regularly and exclusively on the property, and (2) the employer fails to show that the contractor has one or more reasonably non-trespassory alternative means of communication (meaning they do not require using the employer’s property). Under the *UPMC* case, which is current

Board precedent, employers have the right to refuse union access to even public spaces on an employer’s property.

Under the new Board, the state of the law is likely to return to the *New York New York Hotel and Casino* standard, under which employers could *not* restrict off-duty employees from using non-work areas to distribute pro-union literature. Similarly, the *UPMC* standard is likely to be overturned in favor of the prior *Sandusky Mall* standard, under which employers could not restrict a union from using public spaces on an employer’s property for union organizing activity if the employer permitted other commercial, civil, and charitable activities in that space. Close scrutiny by employers of the current Board precedent, and changes in this area, is advised where the company is facing union organizing activities in order to avoid the filing of an unfair labor practice charge and possible implementation of a bargaining order.

## **D. Expansion of Interpretation of Protected Concerted Activity**

Employers can also expect an expanded interpretation of Section 7 “protected concerted activities” under the new Board and general counsel. This may include expanded rights of employees to use their employer’s communication systems for protected activity. The general counsel memo specifically identifies cases in which an employee’s right to use the company email system (or other company communication systems such as Discord, Slack, or Groupme) for protected workplace communication should be given special attention. The memo identifies the current Board precedent as involving “Board Doctrinal Shifts” (from the prior *Purple Communications* standard, which held that employers must permit their employees to use company email systems to engage in protected activity to the current *Rio All-Suites Hotel and Casino*, which overruled *Purple Communications* and permits employers to restrict such employee email communications). The general counsel memo also identifies current board precedent that narrowed the scope of protected activity as requiring reexamination. Specifically it references current Board precedent that employees who acted on behalf of interns were not engaged in protected activity because it was not for “mutual aid and protection.”



This signals that the general counsel and Board will seek to expand the definition of “mutual aid and protection” and thereby the definition of protected concerted activities. With these and other related examples, employers can expect a return to an expanded view of protected concerted activities, which will restrict the actions employers can take with respect to such activities even if the actions are impermissible under current law.

These are just some of the examples of changing precedent from the NLRB that are likely to affect unionized and nonunionized employers alike. The changes are all union-friendly and likely to help fuel

increased union activity in the coming years. As with the quickly changing legal environment respecting COVID related issues, manufacturing employers should stay up to date on new decisions from the NLRB (and be aware of enforcement priorities of the general counsel) to avoid labor-related liability in 2022 and beyond.

As these examples highlight, manufacturing employers face unique challenges in 2022 due to a frequently changing legal landscape. Employers should be vigilant regarding updates to the current state of the law in these and other areas.



# CPSC Continues Enforcement Push in the First Quarter of 2022

*This article covers the first quarter of 2022 (Jan. 1, 2022 through March 31, 2022).*

As predicted based on agency indications in 2021,<sup>1</sup> the Consumer Product Safety Commission (“CPSC”) has continued its push towards increased enforcement<sup>2</sup> in the first quarter of 2022. While recall trends this quarter (and over the past several years) have not been the best indicator of increasing enforcement,<sup>3</sup> initial appearances can be deceiving. As recent news in the exercise industry has shown, the CPSC will not shy away from unilateral action even in the case of a voluntary recall.<sup>4</sup> Additionally, the agency seems to be focusing increased attention on other mechanisms, including fines and administrative actions.

The enforcement push may be attributable to several factors, including the Senate Commerce Committee’s December 2019 conclusion that the CPSC has been too lenient on manufacturers whose products may pose dangers to consumers.<sup>5</sup> Since then, and after the election of President Biden, the composition of the Commission has changed. Joining Republican-appointed Commissioners Dana Baiocco and Peter Feldman are Democrat-appointed Commissioner Richard Trumka, Jr. and Chair Alexander Hoehn-Saric,

1. Erik K. Swanholt & Kristin M. Sikora, *Consumer Product Companies Beware! CPSC Expected to Ramp up Enforcement of Product Safety Regulations*, (Feb. 24, 2021), <https://www.foley.com/en/insights/publications/2021/02/cpsc-enforcement-of-product-safety-regulations>.

2. See Erik K. Swanholt & Kristin M. Sikora, *CPSC Takes First Step to Expand Enforcement* (Apr. 21, 2021), <https://www.foley.com/en/insights/publications/2021/04/cpsc-takes-first-step-expand-enforcement>.

3. The CPSC reported 74 recalls in the first quarter of 2022, 256 recalls in 2020, and 219 recalls in 2021. See <https://www.cpsc.gov/Recalls>.

4. CPSC sharing link to a video of a child being injured by the Peloton Tread+ (Apr. 17, 2021), <https://www.cpsc.gov/Newsroom/News-Releases/2021/CPSC-Warns-Consumers-Stop-Using-the-Peloton-Tread>.

5. Press Release (Dec. 19, 2019), <https://www.commerce.senate.gov/2019/12/senate-commerce-committee-report-details-failures-by-the-u-s-consumer-product-safety-commission-to-protect-consumers>.



## AUTHORS

Erik Swanholt | [eswanholt@foley.com](mailto:eswanholt@foley.com)

Kristin Sikora | [ksikora@foley.com](mailto:ksikora@foley.com)

Amanda Soler | [asoler@foley.com](mailto:asoler@foley.com)

confirmed in October 2021.<sup>6</sup> One commissioner position remains open,<sup>7</sup> and President Biden has nominated Mary Boyle, the agency’s current executive director, to fill it. (Her nomination remains pending before the Senate Committee on Commerce, Science, and Transportation.<sup>8</sup>) If confirmed, the CPSC would constitute a 3-2 split in favor of Democratic appointees; however, how that will impact the CPSC’s path forward is unclear. What does seem clear, is the Commission’s effort to distance itself from the perception that it is too lenient and to emphasize that it “will use its authority to the fullest to keep American families safe.”<sup>9</sup> As further described below, this means increased activity.

## Statements Signaling Increased Activity

The CPSC has leaned into increased activity, and the agency has allocated funds to initiatives that support this stated goal. Individual commissioners have also expressed support for agency programs and objectives that naturally result in increased enforcement.

6. See Chair, <https://www.cpsc.gov/About-CPSC/Chairman/Alexander-Hoehn-Saric>.

7. See Current Commissioners, <https://www.cpsc.gov/About-CPSC/Commissioners>.

8. See PN1542, <https://www.congress.gov/nomination/117th-congress/1542?s=1&r=16>.

9. Remarks of CPSC Chair Alexander Hoehn-Saric, International Consumer Product Health and Safety Organization (ICPHSO) 2022 Annual Meeting, (Feb. 16, 2022), <https://www.cpsc.gov/s3fs-public/Hoehn-Saric-Speech-at-ICPHSO-CPSC-50th-anniversary.pdf?VersionId=pQbe-blvNvsJpQ3wNI047026W1x7Vgu8>.



For example, on September 28, 2021, Commissioners Dana Baiocco and Peter Feldman released a joint statement announcing the passage of the agency's fiscal year 2022 operating plan via a 2-to-1 vote.<sup>10</sup> The joint statement emphasizes several aspects of the agency's plan, including the following:

- **Robust port surveillance** by expanding staff (i.e., adding an additional 27 port inspectors), focusing on facilities where low-value eCommerce shipments enter the country and through the development of an eFiling Program to enhance targeting capability;
- **Vigorous compliance** by strengthening agency enforcement operations through a nearly 30% increase in resources for the Office of Compliance and movement to reinstate the Children's Product Defect Team that was disbanded in 2018, and investing in enforcement technology;
- **Hazard identification** by investing in staff, research, testing capabilities, expanded laboratory facilities, and high-quality data that informs decision making;
- **Communications** by increasing the Office of Communications operating budget by nearly 25% to allow the agency to maintain a robust Internet presence that includes traditional social media, CPSC websites, and apps to track product safety developments;
- **Security and accountability improvements** by taking steps to address the CPSC Inspector General's recommendations, including those related to the 2019 data breach, and establishing security policies to guard against known cyber risks; and
- **Diversity and product safety equity** by enhancing recruitment efforts, analyzing workforce data, and developing proactive programs that seek to foster inclusion, equity, and diversity and by better serving vulnerable, diverse, and disenfranchised communities through targeted communications and outreach.<sup>11</sup>

10. Joint Statement of Commissioners Dana Baiocco and Peter A. Feldman on the Passage of the Fiscal Year 2022 Operating Plan, Consumer Product Safety Commission (Sept. 28, 2021), <https://www.cpsc.gov/s3fs-public/FY22OpPlanJointStatement.pdf?VersionId=vYdSOfbkYTyz.Xpl9UOf1AACeGW3evJ>.

11. Id.; see also Memorandum from Mary T. Boyle to the Commission attaching the Consumer Product Safety Commission's Fiscal Year 2022 Operating Plan (Sept. 15, 2021), <https://www.cpsc.gov/s3fs-public/Commission-Briefing-Package-Fiscal-Year-2022-Operating-Plan-Web.pdf?VersionId=CiBFs8luv3qhs8jA9HubboRTV2um.BiA>.







More recently, Chairman Hoehn-Saric stated that it is his “preference to see speedy reporting and remedial action by manufacturers... [but that] the CPSC will not hesitate to move forward on our own when ... [manufacturers] refuse to conduct recalls when our staff finds their product presents a substantial product hazard.”<sup>12</sup> He also affirmed the Commission’s aggressive tack on reporting by stating “failing to report dangerous products puts consumers at an unnecessary risk and will not be tolerated,” which is why “in the last 5 months [the CPSC has announced] close to \$100 million in penalties” for failures to report and late reporting.<sup>13</sup> Commissioner Peter Feldman’s recent tweets echo this same sentiment, as he has expressed support for increased rulemakings to improve the safety of adult portable bed rails<sup>14</sup> and voted to oppose a corrective action plan that did not clearly identify how the proposed remedy would benefit future consumers.<sup>15</sup>

Not only is the CPSC increasing activity generally, but it is also specifically considering the racial disparities in injury rates and deaths caused by consumer products. On April 14, 2022, the CPSC announced a public forum for all interested stakeholders to discuss its newly released Equity Action Plan that focuses on improving data collection “to better assess disparities and [the CPSC’s] efforts to reach the communities that are most in need.”<sup>16</sup>

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12. Remarks of CPSC Chair Alexander Hoehn-Saric, International Consumer Product Health and Safety Organization (ICPHSO) 2022 Annual Meeting, (Feb. 16, 2022), [https://www.cpsc.gov/s3fs-public/Hoehn-Saric-Speech-at-ICPHSO-CPSC-50th-anniversary.pdf?VersionId=pQbe\\_blvNvsJpQ3wNI047026W1x7Vgu8](https://www.cpsc.gov/s3fs-public/Hoehn-Saric-Speech-at-ICPHSO-CPSC-50th-anniversary.pdf?VersionId=pQbe_blvNvsJpQ3wNI047026W1x7Vgu8).

13. *Id.*

14. Twitter @FeldmanCPSC (Mar. 16, 2022), <https://twitter.com/feldmancpsc>.

15. Twitter @FeldmanCPSC (Apr. 7, 2022), <https://twitter.com/feldmancpsc>.

16. *CPSC Announces Stakeholder Roundtable on May 25, 2022 to Hear from Public on New Equity Action Plan; Joins Over Ninety Federal Agencies Releasing Equity Action Plans* (Apr. 14, 2022), <https://www.cpsc.gov/Newsroom/News-Releases/2022/CPSC-Announces-Stakeholder-Roundtable-on-May-25-2022-to-Hear-from-Public-on-New-Equity-Action-Plan-Joins-Over-Ninety-Federal-Agencies-Releasing-Equity-Action-Plans>.



## CPSC Voluntary Recalls and Notices of Violation

In the first quarter of 2022, the CPSC announced 74 recalls, including several infant and children's products, recreational vehicles, and novelty items.<sup>17</sup>

The CPSC also issued several product violation notices. Data available through February 2022 shows that the CPSC issued 426 Notices of Violations.<sup>18</sup> Most of these violations are "Stop Sale and Correct Future" or "Correct Future Production."<sup>19</sup>

Notably, manufacturers and retailers in the exercise industry were the subject of increased CPSC interest and activity. First, the CPSC recalled certain treadmills due to fire hazard risks.<sup>20</sup> Then, on January 31, 2022, the CPSC issued a \$6.5 million penalty against an exercise manufacturer for failure to immediately report serious injuries involving its exercise equipment, specifically cable crossover machines and dual adjustable pulley machines.<sup>21</sup>

## Continued Rise of Actions Related to Infant and Child Safety

Consistent with its efforts last year,<sup>22</sup> the CPSC has maintained its focus on infant and child safety.<sup>23</sup> On January 26, 2022, the CPSC approved a new federal mandatory standard related to crib mattresses that takes effect in the fall of 2022.<sup>24</sup> The new federal rule will include marking, labeling, and instructional literature improvement requirements aimed at reducing infant injuries and deaths related to suffocation, entrapment, and laceration hazards.<sup>25</sup>

17. See <https://www.cpsc.gov/Recalls>.

18. See <https://www.cpsc.gov/Recalls/violations>.

19. "For all products regulated by the CPSC, the Commission issues a Letter of Noncompliance when there is a violation of a mandatory standard. It advises the company of the violation and of the nature of the necessary corrective action (to correct future production (CFP); to stop sale and CFP; or to recall, stop sale, and CFP)." <https://www.cpsc.gov/es/Data>.

20. Recall Alert (Jan. 28, 2022), <https://www.cpsc.gov/Recalls/2022/Johnson-Health-Tech-Recalls-Matrix-T1-and-T3-Commercial-Treadmills-Due-to-Fire-Hazard-Recall-Alert>.

21. Press Release (Jan. 31, 2022), <https://www.cpsc.gov/Newsroom/News-Releases/2022/Core-Agrees-to-Pay-6-5-Million-Civil-Penalty-for-Failure-to-Report-Serious-Injuries-Involving-its-Exercise-Equipment>.

22. Erik K. Swanholt & Kristin M. Sikora, *Recent Activity on Infant and Child Safety* (Oct. 7, 2021), <https://www.foley.com/en/insights/publications/2021/10/recent-activity-on-infant-and-child-safety>.

23. See Press Release (Jan. 26, 2022), <https://www.cpsc.gov/Newsroom/News-Releases/2022/CPSC-Approves-New-Federal-Safety-Standard-for-Crib-Mattresses-Rule-to-Provide-a-Safer-Marketplace-for-Parents>.

24. *Id.*

25. *Id.*

Many of the recalls issued so far in 2022 relate to infant and child safety.<sup>26</sup> Notably, when an infant products company refused to undertake a voluntary recall following two infant deaths, the CPSC filed an administrative complaint addressing suffocation hazards related to their infant lounger products.<sup>27</sup> The CPSC's complaint asks for an order, among other things, requiring the company to notify all persons who sell or distribute the products to immediately cease distribution, notify state and local public health officials, give prompt public notice (including posting a clear and conspicuous notice on their website and on any third-party website they have a presence on, including social media), and to mail and email a notice to every distributor, retailer, and purchaser.<sup>28</sup> This case is ongoing.

## New Trend: Penalties for Failure to Report

Manufacturers, importers, distributors, and/or retailers of consumer products have a legal obligation to immediately report product safety hazards and defects to the CPSC. This reporting obligation covers: (1) A defective product that could create a substantial risk of injury to consumers; (2) A product that creates an unreasonable risk of serious injury or death; (3) A product that fails to comply with an applicable consumer product safety rule or with any other rule, regulation, standard, or ban under the CPSA or any other statute enforced by the CPSC; (4) An incident in which a child (regardless of age) chokes on a marble, small ball, latex balloon, or other small part contained in a toy or game and that, as a result of the incident, the child dies, suffers serious injury, ceases breathing for any length of time, or is treated by a medical professional; and (5) Certain types of lawsuits.<sup>29</sup> Failure to fully and immediately report this information may lead to civil or criminal penalties.<sup>30</sup> Generally, CPSC staff advises "when in doubt, report."<sup>31</sup>

26. See <https://www.cpsc.gov/Recalls>.

27. Press Release (Feb. 9, 2022), <https://www.cpsc.gov/Newsroom/News-Releases/2022/CPSC-Sues-Leachco-Over-Suffocation-Hazard-from-Defective-Infant-Loungers-Seeks-Notice-and-Refund-to-Consumers-from-Company>.

28. See Recall Lawsuits: Adjudicative Proceedings, <https://www.cpsc.gov/Recalls/Recall-Lawsuits-Adjudicative-Proceedings>.

29. See Duty to Report to CPSC: Rights and Responsibilities of Businesses, <https://www.cpsc.gov/Business-Manufacturing/Recall-Guidance/Duty-to-Report-to-the-CPSC-Your-Rights-and-Responsibilities>.

30. *Id.*

31. *Id.*

The Chair's recent statements about failure to report and late reporting, combined with agency actions, signal that the CPSC will be paying increased attention to lax reporting.<sup>32</sup> For example, in January 2022, the CPSC resolved a failure to report complaint with a civil penalty of \$6.5 million.<sup>33</sup> The CPSC generally issues at least one civil penalty a year, but it issues criminal penalties much more rarely. Indeed, before the agency's historic corporate criminal enforcement action in 2021, the last criminal penalty was issued in 2013.<sup>34</sup> Given the CPSC's resurrection of the criminal penalty in 2021 and early foray into civil penalties this year, industry should be prepared for increased penalty activity in 2022 and beyond, particularly as it relates to reporting obligations.

### Other CPSC Administrative Actions

Of particular significance is a pending recall lawsuit against Amazon. The CPSC filed its complaint against Amazon on July 14, 2021 regarding various products, including children's sleepwear products that failed to meet flammability requirements, carbon monoxide detectors that failed to detect carbon monoxide, and hair dryers without proper safety immersion protections.<sup>35</sup> Although Amazon notified customers that the products could present a hazard and offered a refund in the form of an Amazon gift card, the CPSC alleged these actions were insufficient to remediate the hazards posed by the products and did not constitute a fully effectuated mandatory corrective action.<sup>36</sup> This complaint marks a departure from the CPSC's custom of seeking enforcement against manufacturers; instead, here the CPSC targeted the distributor by suing the e-marketplace that sells the

manufacturers' items. The CPSC explained that it "must grapple with how to deal with these massive third-party platforms more efficiently, and how best to protect the American consumers who rely on them."<sup>37</sup> Distributors like Amazon can expect such increased scrutiny from the CPSC to continue.

Interestingly, the CPSC has also shown that it will not tolerate ex parte communications following the issuance of a complaint. Two days after Amazon received the complaint, representatives for Amazon attempted to "propose a meeting . . . to discuss a path forward . . ." in three separate emails to the CPSC.<sup>38</sup> Such ex parte communications are prohibited and are publicly posted on the CPSC's website. The last time the CPSC posted prohibited ex parte communications was November 28, 2017.<sup>39</sup> The Amazon case remains ongoing; the CPSC issued a subpoena to the Government Accountability Office on March 22, 2022.<sup>40</sup>

### What Does It All Mean?

If the CPSC's recent activity is any indicator, the industry can expect to see more aggressive enforcement in the form of the usual voluntary recalls but also fines, forced recalls, and enforcement actions. The CPSC is likely to continue acting independently and publicly sharing its concerns about the safety of particular consumer products without agreement from or cooperation with targeted manufacturers or distributors.

For those companies under the CPSC's purview, it is important to be proactive both in terms of continued (and, if appropriate, improved) product safety vigilance and in the creation and maintenance of a product safety program, so that responding to and reporting product safety issues occurs as quickly as possible.

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32. Remarks of CPSC Chair Alexander Hoehn-Saric, International Consumer Product Health and Safety Organization (ICPHSO) 2022 Annual Meeting, (Feb. 16, 2022), [https://www.cpsc.gov/s3fs-public/Hoehn-Saric-Speech-at-ICPHSO-CPSC-50th-anniversary.pdf?VersionId=pQbe\\_blvNvsJpQ3wNI047026W1x7Vgu8](https://www.cpsc.gov/s3fs-public/Hoehn-Saric-Speech-at-ICPHSO-CPSC-50th-anniversary.pdf?VersionId=pQbe_blvNvsJpQ3wNI047026W1x7Vgu8).

33. See Press Release (Jan. 31, 2022), [https://www.cpsc.gov/Newsroom/News-Releases/2022/Core-Agrees-to-Pay-6-5-Million-Civil-Penalty-for-Failure-to-Report-Serious-Injuries-Involving-its-Exercise-Equipment#:~:text=Core%20Agrees%20to%20Pay%20\\$246.5,its%20Exercise%20Equipment%20%7C%20CPSC.gov](https://www.cpsc.gov/Newsroom/News-Releases/2022/Core-Agrees-to-Pay-6-5-Million-Civil-Penalty-for-Failure-to-Report-Serious-Injuries-Involving-its-Exercise-Equipment#:~:text=Core%20Agrees%20to%20Pay%20$246.5,its%20Exercise%20Equipment%20%7C%20CPSC.gov)

34. See Press Release (Oct. 29, 2021), <https://www.justice.gov/opa/pr/gree-appliance-companies-charged-failure-report-dangerous-dehumidifiers-and-agree-91-million#:~:text=Consistent%20with%20Justice%20Department%20policy,%2491%20million%20total%20monetary%20penalty;https://www.cpsc.gov/Business--Manufacturing/Civil-and-Criminal-Penalties>.

35. *Id.*

36. *Id.*

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37. Press Release (July 14, 2021), <https://www.cpsc.gov/Newsroom/News-Releases/2021/CPSC-Sues-Amazon-to-Force-Recall-of-Hazardous-Products-Sold-on-Amazon-com>.

38. *Id.*

39. *Id.*

40. *Id.*



# Mexico Nearshoring Trends Across the Manufacturing Landscape

Many of the certainties to which businesses had grown accustomed over the last decade have been shaken, and there are a number of issues over which companies have absolutely no control. In this article we provide a path for companies to begin addressing international manufacturing in an incessantly changing world.

The demand is still out there, likely under new challenges, and your company's ability to fulfill it may need some readjustment. Such rearranging may involve repositioning your global resources based on proximity to where they will be needed, rather than primarily focusing on cost of production (practice commonly referred to as "nearshoring" or "reshoring").

Many North American companies looking to employ a nearshoring or reshoring strategy are studying Mexico as a possible location for production. This article considers several of the key issues that companies should ponder when evaluating a closer-to-home strategy and, in particular, considerations for doing business in Mexico.

## Choose Your Markets and Locations for Production

The first step for any company considering a reshoring or nearshoring strategy is to determine where in the world lies the demand that your company will be supplying. In other words, which shore?

Most companies will begin with their current markets; however, if they are languishing or if a company needs some room to grow, the logical way to go about it is to look for new target destinations with an appetite for exactly the type of products you are offering. One simple way to do this is to look into publicly available information regarding the largest import markets for your company's production.



## AUTHORS

Alejandro Gomez | [agomez@foley.com](mailto:agomez@foley.com)

Nicholas Ellis | [nellis@foley.com](mailto:nellis@foley.com)

The Harmonized Tariff Schedule (HTS) groups global imports and exports at the same six-digit levels and then grows within each country up to 10- or 12-digit numbers that allow a user to identify more details in that six-digit tree trunk. Once companies have identified their potential untapped markets (largest importers of your products), they can use publicly available information to look into the country's national apparent consumption, that is, the result of domestic production plus imports minus exports, to determine the true size of the market.

The decision as to what markets a company should target will then drive where to locate production in order to shorten supply lines. For companies serving the U.S., but for which local production is not an option, a logical choice is to consider Mexico as a manufacturing location.

Mexico offers a number of advantage as a nearshoring location — these are relatively known, yet they make a compelling case for the country when read together:

- Mexico benefits from *access certainty* to the USMCA region, a rare advantage in recent times;
- Mexico represents the lowest-cost manufacturing site within USMCA;
- Mexico's workforce has significant experience in heavy and complex manufacturing;



- Import duties are practically nonexistent, delivery lead times are hard to match by any other country in the world, time zones largely coincide with those in the U.S., and main manufacturing locations have direct flights out of the U.S.;
- Mexico offers a number of trade facilitation programs that have been proven to work throughout the years;
- Mexican-origin exports enjoy preferential tariff access to the world’s most attractive destination markets, due to the extended net of Free Trade Agreements; and
- The USMCA grants Mexican exports favorable treatment regarding potential trade remedies and U.S. national security measures.

### **Take Advantage of the Manufacturing Efficiencies of Several Countries at the Same Time**

When deciding on a location for production, there are many cost elements that must be considered. In addition to cost of labor, utilities, raw materials, etc., companies must consider the impact of various tariffs, duties, and non-tariff regulations<sup>1</sup> that will apply when importing material/components into the country where goods are produced, plus any additional charges associated with export/import of the final goods.

While some costs cannot be changed, there are ways in which companies can affect the tariffs, duties, and non-tariff regulations to which they are subject. This can be done through the lawful “engineering” of Rules of Origin, that is, working around the amount of inputs, processing, and overall transformation that

1. Special permits, reference prices, quotas, previous notices, etc. may be required for a product to be imported.

foreign-made inputs have to go through in order to be considered Mexico-originated and enter the U.S. under a reduced — which can be as low as 0% — import duty rate, as per the USMCA.<sup>2</sup>

We should always keep in mind that all cost-saving venues bring with them a naturally associated level of compliance red-tape that your company should be fully observant of. This requires an orderly effort and, as your company is usually busy as an active manufacturer, it ordinarily needs outside professional help of some sort.

### **Opportunities in Mexico to Replace Tariff-Penalized Chinese Goods**

Although some have argued that Vietnam and other nations could be the winners in the U.S.-China trade war<sup>3</sup>, Mexico has many advantages that may tip the odds in its favor. It is important to note that during 2019<sup>4</sup> the sum of tariff rates and transportation cost rates regarding imports into the United States was 1.09% for Mexican products, as opposed to 14.28% for Chinese products, and 10.62% for Vietnamese products.<sup>5 6</sup>

2. Another way to look into this is working around the overall processing done in Mexico to bring the semi-finished product to be completed in the U.S. and considered as a Made in USA product.

3. Enrique Dussel-Peters “TRADE OPPORTUNITIES FOR MEXICO IN THE CONTEXT OF THE TENSIONS BETWEEN THE UNITED STATES AND CHINA SINCE 2017”. OCTOBER 2021. Tenaris Tamsa. p. 10.

4. Unfortunately, the latest available data at this level of detail. More recent facts below.

5. Breakdown of the sum of tariff rates + transportation cost rates regarding imports into the United States from Mexico: tariff rate of 0.20% + transportation cost rate of 0.89% = 1.09%. For imports from China: tariff rate of 9.81% + transportation cost rate of 4.47% = 14.28%. And for Vietnamese products: tariff rate of 6.56% + transportation cost rate of 4.06% = 10.62%.

6. Dussel-Peters. “TRADE OPPORTUNITIES FOR MEXICO...” pp 9 and 10.



Most companies would agree that by now the U.S. China trade war has made the Chinese-origin goods less attractive due to increased tariffs. Recent data holds that, as of mid-2022, the average import duty rate for Chinese exports was 19.3%,<sup>7</sup> while for Mexico was virtually non-existent when complying with USMCA rules or origin requirements. Regarding transportation, the average price for shipping a container from China into the U.S. was approximately \$10,000, while the cost for crossing a truck from Mexico into the U.S. could be as low as \$250<sup>8,9</sup>

This creates an opening that may be filled by other exporting countries. Dussel-Peters has identified a list of six-digit HTS subheadings — 77 in total — in which the Chinese share of imports into the United States fell beyond its -3.51% average during 2017–2019, and in which the Mexican imports increased above its 0.97% average during the same period, 2017–2019.<sup>10</sup> The relevance of these 77 subheadings is that Mexico already counts with the for-export production capacity to replace the void left by the Chinese imports; this means that the capacity is already there for exporting into the U.S.

Finally, Mexican manufacturing heavily relies on trade promotion programs, which require significant periodic filings to the Government;<sup>11</sup> in addition, as Mexico utilizes over 1/3 of foreign content<sup>12</sup> in its manufacturing exports — with electronics, automotive, and auto parts standing out for their high levels — it is vital to be counseled properly in order to maintain an orderly manufacturing operation in the country.

7. <https://www.piie.com/research/piie-charts/us-china-trade-war-tariffs-date-chart>, consulted May 27, 2022.

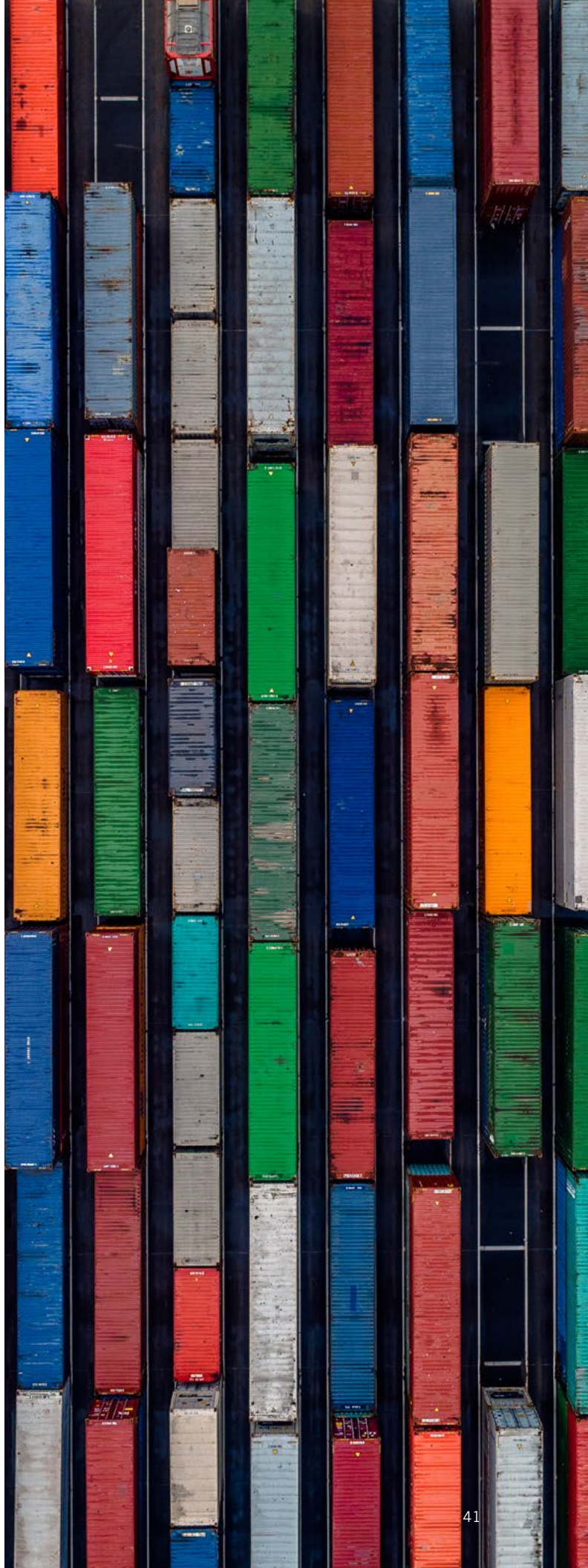
8. <https://www.businessinsider.com/shipping-costs-inflation-outlook-container-prices-high-supply-chain-crisis-2022-3>, consulted May 27, 2022.

9. <https://www.ivemsa.com/mexico-competitive-manufacturing-costs/>, consulted May 27, 2022.

10. Dussel-Peters. “TRADE OPPORTUNITIES FOR MEXICO...” Appendix 9, <https://dusselpeters.com/357.pdf>, consulted May 27, 2022.

11. Namely the *Maquila* program (all Maquila authorizations have by now converted into IMMEX permits which stand for Manufacturing, Maquila, and Export Services Industries Program), the Sectorial Promotion Program (PROSEC), Eighth Rule Permit, Refund of Import Duties to Exporters (Drawback), Inspection at Origin (Clearance Registry), and Integral Companies Certification Scheme (Certified Companies Registry).

12. 36.4% in 2016. Dussel-Peters. “TRADE OPPORTUNITIES FOR MEXICO...” p. 12.



# Strategic IP for Protection of Product Manufacturers

Product manufacturers must aggressively protect their markets by managing a comprehensive intellectual property strategy. Depending on the nature of the manufacturer, patents, trademarks, copyrights, and/or trade secrets are essential to reducing external competition. A strong IP program may also dissuade existing employees and executives from becoming a future competitor. Many manufacturers have learned the hard way that the cost of not having a strong IP program is ultimately more costly than not having one.

Manufacturing products requires a company's full commitment for successful execution. Manufacturing is an all-encompassing activity, starting with conceiving a product to create, then performing research and development (R&D), and ultimately performing production. Depending on the nature of the product being produced, the magnitude of complexity can range from simplistic to futuristic. Those in manufacturing know that no matter how simple a product is to produce, the cost of manufacturing can be significant due to labor and materials.

One risk that a manufacturer often cannot control is competition. Competition comes in various forms, ranging from fair competitors, who produce products that perform similar functions, to unscrupulous competitors, who “knock off” or copy a product. Another type of competitor is the one that intentionally creates a product that is very similar but strategically avoids intellectual property of the product being produced (commonly referred to as a “design-around”). Yet another type of competitor is that of a former employee who learns (or steals) from you and competes using what was learned or inappropriately taken.

While competitor risk is unpredictable, one way to minimize competition is to strategically create, procure, and enforce intellectual property. With the significant costs of R&D, manufacturing, and market risks, the ability to protect the investment of creating and marketing products is important. With the added risk of unscrupulous “knock-off” competitors (often from non-U.S. countries) and competitors that



AUTHOR

Gary Solomon | [gary.solomon@foley.com](mailto:gary.solomon@foley.com)

design-around intellectual property meant to protect the investment, the value of a strategic intellectual property program is that much more of an imperative.

## Intellectual Property and Manufacturer Types

Intellectual property includes patents, trademarks, copyrights, trade secrets, and know-how, and each of these assets perform different functions that protect against would-be and actual competitors. In protecting manufacturers, a holistic approach to intellectual property is strongly recommended, meaning one IP type is often not enough.

There are two types of manufacturers considered in this article: (1) contract manufacturers who produce products for marketers of products and (2) brand product companies who either manufacture their own products or have the products manufactured by contract manufacturers. In each of these manufacturer types, managing intellectual property is an important factor for protection of products and/or manufacturing processes to produce the products.

## IP Considerations for Protecting Products

Manufacturers in the 21<sup>st</sup> century must be nimble and capable of fast execution. Competition has never been so fierce because of the proliferation of the global economy, including typical market competitors, former manufacturers, and future competitors who currently work within the company, just to name a few.



Historically, companies mainly faced competition within the U.S., but the ease of transportation and ecommerce makes anyone around the world a potential competitor. While technology increases the speed of product development, technology, such as 3D laser scanners and mass spectrometry, increases the speed of reverse engineering and copying others' products.

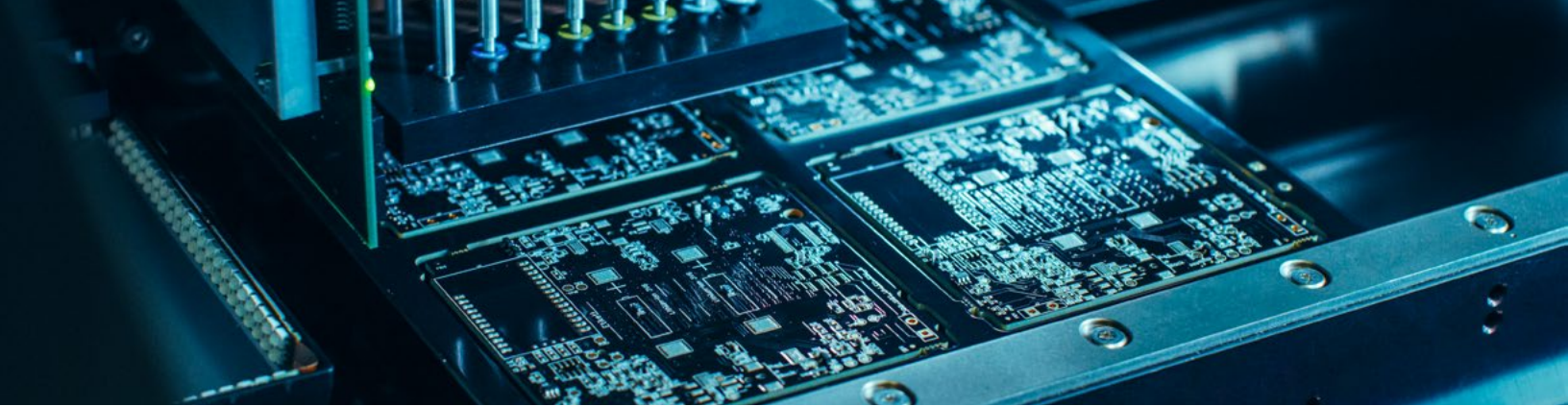
### **Manufacturer Competition Challenges**

For brand product companies, copycats can weaken or erode a product marketplace or create significant pricing pressures. And the more popular the brand, the faster the competitors show up. To make business even more challenging, the ability of competitors to distribute knock-off or competitive products has become much easier on ecommerce sites on which manufacturers or distributors create listings or virtual stores.

For contract manufacturers, competitor manufacturers can be a "race to the bottom" in terms of manufacturing margins, especially if the contract manufacturer spent time and resources to develop manufacturing processes. By way of examples, for a glass manufacturer that develops improved glass, an antenna manufacturer that develops antennas, or a pharmaceutical manufacturer that develops processes that increase production yields, the cost of developing those products and processes can be very expensive.

Patents can be used to protect the products (e.g., glass, antennas, or medicines) but also may be used to protect the systems and processes for producing the products. Patents protect the structure, function, and ornamental appearance of the physical goods, but may also protect software and processes to produce the products. Trademarks are used to protect the names and logos of the goods but also may be used in some cases to protect the trade dress or physical appearance of the physical goods. Copyrights may protect software used to operate the physical goods (e.g., automobile) but also may be used to protect the equipment used to produce the physical goods. Trade secrets may protect the physical goods (e.g., formula of medicine or beverage), but may also be used to protect how the physical goods are produced (e.g., techniques for producing glass or chemical compositions). Each of these intellectual property types are usable for the different competitive situations that both contract manufacturers and brand product companies face.





## Quality Intellectual Property and Strategic IP Program to Protect Manufacturers

The stakeholders of manufacturers include investors and employees. If competitors begin to erode market share, the choice a company has is to either enforce their intellectual property rights or win the marketing game. To enforce intellectual property rights, however, quality intellectual property and a strategic intellectual property program is typically needed. “Quality intellectual property” means that quality patents, strong trademarks, timely filed copyrights, and well-managed trade secrets exist or are at least in process. “Strategic intellectual property” means that intellectual property assets are created during the early stages of product development (e.g., while R&D efforts are underway) and are carefully crafted. Strategic intellectual property must continue throughout the lifetime of a product or production cycle (e.g., maintain a pending patent application to allow for alternative protection when the competitors arrive). Also, as new technologies are developed, new intellectual property should be created.

When competitors appear, a thoughtful analysis of all facets of the intellectual property of a manufacturer should be considered for existing infringement and for whether future IP can be procured based on pending patent applications, common law trademarks or trade dress, or common law (unregistered) copyrights. Intellectual property takes time to procure — as little as 10 days for an expedited copyright filing when an infringement exists, four-to-six months for an expedited patent application, a year for a trademark, and potentially years for patents, depending on the nature of the invention. Hence, a strategic and comprehensive enforcement plan needs to be determined as early as possible when a competitor appears.

It is important for companies to complete some IP housekeeping to protect their ideas. These include:

- **Patent Assignment Provision:** All executives, employees, and contractors/consultants need to be under a duty to assign intellectual property, most notably inventive ideas. An inventor is the first owner of the inventive ideas, even when written into a patent application paid for by a company. Without a written assignment, the invention owner is the employee or even executive. If that employee or executive leaves the company with the idea to either become a competitor or join a competitor without that innovation being assigned in writing, an instant competitor may exist. Worse yet, if that same inventor licenses that unassigned innovation to a competitor (yes, it is legal!), a bigger problem may exist for the stakeholders. Include the patent assignment in an employment agreement to help deter executives, employees, and contractors from becoming competitors.
- **Copyrights:** For products that include software, a copyright application should be filed with the U.S. Copyright Office for each and at each major update. A copyright filing within three months of publication ensures statutory damages (and often attorney fees) in the event of infringement. Although copyrights are automatically assigned to the company by employees, contractors do not have the same automatic assignment, so absent a work-for-hire provision in a consulting agreement, for example, the software, photographs, videos, etc. may not be owned by the company.
- **Trade Secret Protection:** Maintain a list of trade secrets and limit access to individuals with a need-to-know status in the event an employee, executive, or other individual leaves a company with the “crown jewels” of the company. For software, file a copyright application with redacted source code to claim trade secret protection where possible.



## Intellectual Property Tips for Manufacturers

**Keep Your Finger on the Pulse:** Manufacturing and new product development happens fast and has the ability to change manufacturing techniques and product specifications rapidly. As a result, it is important to ensure the intellectual property for protecting the manufacturing techniques and product specifications ultimately reflects the final product. Hence, manufacturing and product managers should be tasked with ensuring the IP stays current for each product.

**Identification of IP Rights:** Engineers tend to dismiss their own creativity by thinking whatever they develop is just common sense, but solutions to problems during the development stage can be the difference between great IP protection and a competitor appropriating a good idea. As such, “patent harvesting” with engineering design teams is important to adequately identify IP rights for manufacturers.

**Create an IP Game Plan:** Quality IP requires a solid game plan to continuously monitor and protect valuable IP throughout a product lifecycle, starting from R&D to multiple generations of a product.

**Avoiding Other IP:** Avoiding IP owned by others can be a challenge, but as part of the IP game plan, material reduction in time-consuming and expensive IP infringement of IP owned by others can result. Freedom-to-Operate searches can be performed on both the patent and trademark sides, and instructing employees to avoid copying from third parties can help to avoid all areas of IP.

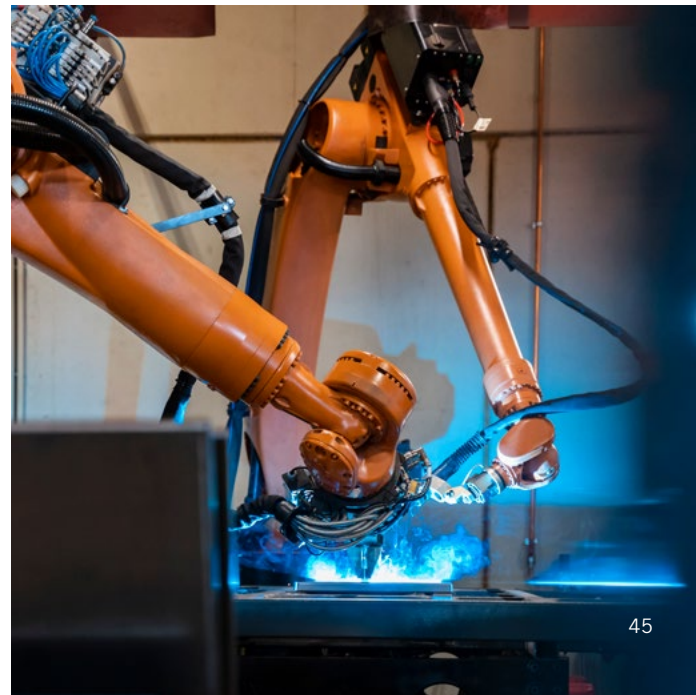
Here’s a strategy for better integrating your IP program with product development to secure the IP earlier in the product lifecycle. Communications should occur in three phases:

1. **After Concept Acceptance but Before Design/ Engineering:** For consumer products, because the cost of patent infringement is so high, it is strongly recommended to conduct a Novelty Search and/ or Freedom-to-Operate Search to help ensure the concept has innovative features that are potentially patentable and help avoid patent infringement. From the search results, the patent counsel can focus on inventive features to protect the product and guide the company on how best to avoid patent infringement. Consider filing a provisional utility patent application and/or design application(s) at this time.

2. **After Engineering Design is Completed:** *Once* the inventive features are learned, file patent application(s). These should be either provisional or non-provisional depending on the potential for the product to further evolve. Budget may also play a factor in the decision. (Note: for products with unique ornamental design features, file design application(s) to avoid unintentional loss of international rights).
3. **After Prototyping is Complete and Prior to Production or Product Announcement:** Perform a final check to see if any additional product features need to be protected. Make sure the company’s workflow includes IP attorney signoff to ensure all patent filings are complete before announcing or releasing the product! Also, ensure trademarks and copyrights are filed and patent and trademark clearance assessments are within acceptable risk tolerances.

## Conclusion

Without a comprehensive intellectual property program, product manufacturers are subject to greater competition. Depending on the industry of the manufacturer, patents, trademarks, copyrights, and/ or trade secrets are essential to reducing external competition. Manufacturers should also maintain an IP program to dissuade existing employees and executives from becoming future competitors. Many manufacturers have learned the hard way that the cost of not having an intellectual property program is ultimately more costly than not having one.



# Enhanced U.S. Government Scrutiny of Supply Chains Increases Compliance Expectations for U.S. Companies that Source from or Operate Abroad

Regulators have sent several recent messages that the U.S. government expects companies to subject their entire supply chain to extensive due diligence, based on state-of-the-art compliance measures. These include the issuance of an unusual briefing by the Departments of State, Treasury, and Homeland Security on the need for supply chain due diligence<sup>1</sup>, a special advisory from the Department of Homeland Security on supply chain due diligence and compliance best practices, and a seven-figure penalty for a company not engaging in “full spectrum” supply chain due diligence<sup>2</sup>. The Office of Foreign Assets Control (OFAC) has also implemented multiple sanctions regimes that target the purchase of goods that rely on human trafficking or forced labor, including special sanctions targeted at the Xinjiang region of China. And finally, Customs now is tasked with blocking goods that are the product of forced labor, including with regard to goods from the Xinjiang region of China, which carry a rebuttable presumption that they are the product of forced labor, unless the importer of record can provide specified proof to the contrary.

1. The Department of Treasury (which contains OFAC), the Department of State, and the Department of Homeland Security issued a special advisory titled “Risks for Businesses with Supply Chain Links to North Korea,” which highlights the risks of economic sanctions evasions and sourcing from companies that rely on forced labor. [https://www.cbp.gov/sites/default/files/assets/documents/2018-Aug/North%20Korea%20Sanctions%20\\_%20Enforcement%20Actions%20Advisory.pdf](https://www.cbp.gov/sites/default/files/assets/documents/2018-Aug/North%20Korea%20Sanctions%20_%20Enforcement%20Actions%20Advisory.pdf).

2. OFAC announced a \$996,080 settlement with a Californian cosmetics company, e.l.f. Cosmetics, Inc. (ELF), for alleged violations of the North Korean Sanctions Regulations based on the company “unknowingly” importing 156 shipments of false eyelash kits from two suppliers in China that contained materials independently sourced by these suppliers from North Korea. [https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20190131\\_elf.pdf](https://www.treasury.gov/resource-center/sanctions/CivPen/Documents/20190131_elf.pdf).



AUTHOR

Greg Husisian | ghusisian@foley.com

Goods associated with any sanctioned country, company, or person can result in economic sanctions issues, including large potential penalties and even personal liability. As a result, it is important for companies that source from or operate abroad to engage in systematic reviews of their supply chains. These companies should not assume their sourcing from third parties, and not their own operations, will shield them from liability for violations of economic sanctions and other laws that target supply chains. With Customs now also taking actions to cut off imports from companies that benefit from forced labor or human trafficking by blocking such goods at the border, the regulatory and reputational stakes from a flawed supply chain have never been higher.

Companies that source internationally accordingly need to take concrete steps to ensure they are sourcing their inputs from clean sources. Thus, companies that source from or operate abroad should strongly consider putting in place the following compliance measures:

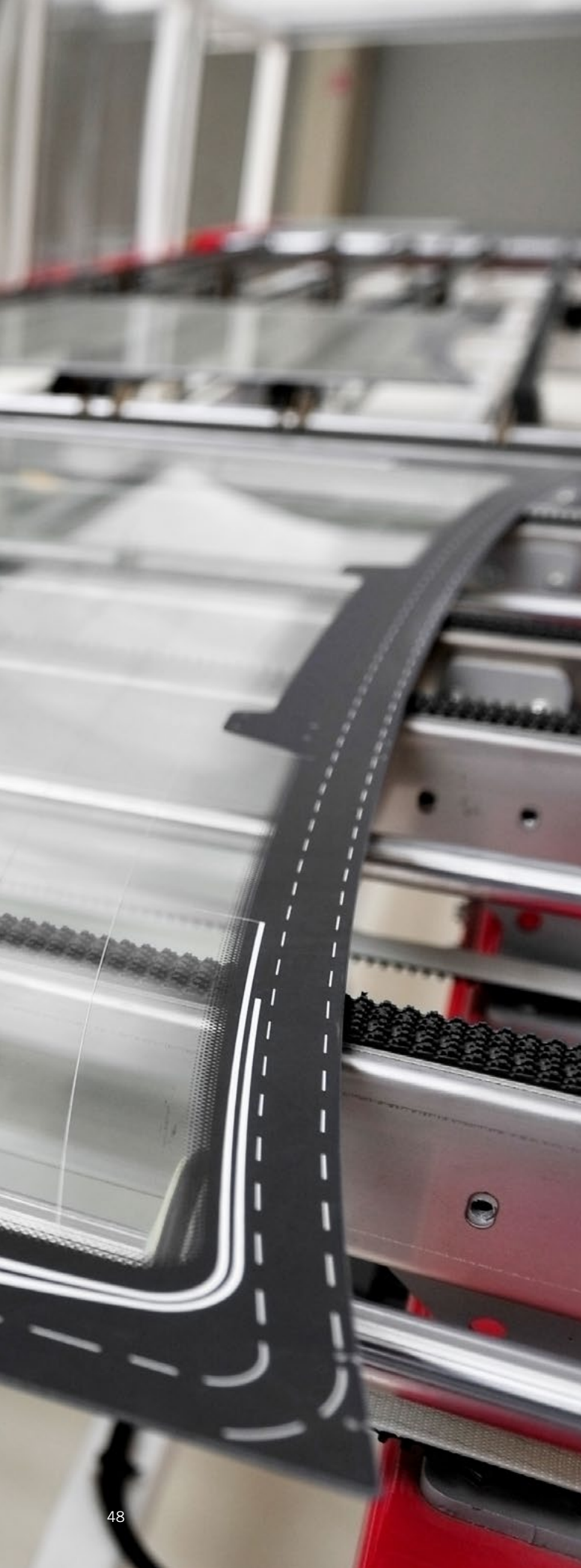
- Performing a systematic risk assessment to determine their key exposure areas for economic sanctions, forced labor, and human trafficking violations across both the company and at its supply base.
- Performing a global review of their terms and conditions for all vendors and suppliers to ensure they reflect current forced labor, human trafficking, and economic sanctions regulatory requirements aimed at suppliers.



- Adopting procedures to require suppliers to sign annual certificates of compliance stating they will comply with all U.S. economic sanctions, forced labor, and human trafficking requirements.
- Taking steps to verify compliance by suppliers with forced labor and human trafficking requirements, including through requiring suppliers to provide proof of adequate and lawful wages paid, compliance with all U.S., EU, Australian, and other applicable forced labor and human trafficking requirements.
- Ensuring suppliers promulgate forced labor and human trafficking contractual requirements to all sub-suppliers and take concrete steps to follow through on the effective implementation of these requirements.
- Conducting supplier audits that include (1) verification of compliance with all forced labor and human trafficking requirements, (2) verification of payment information related to production materials, and (3) the review of supplier bank statements.
- Providing special scrutiny and oversight of companies that source from high-risk jurisdictions such as China, India, and other areas where respect for the rule of law is lower and violations more common.
- Implementing internal controls and oversight systems of company operations and supply chains to ensure compliance responsibilities are adequately carried out.
- Ensuring all screening of suppliers for potential matches to OFAC, EU, and other economic sanctions lists of embargoed persons is occurring regularly, and all suppliers are screening their sub-suppliers for the same type of potential matches.
- Providing economic sanctions training for key employees in the United States and in foreign operations that source abroad regarding U.S. sanctions regulations and other relevant U.S. laws and regulations.
- Disseminating typical red flags that might indicate a violation of the economic sanctions, forced labor, and human trafficking regulations.

As a final note, OFAC stresses not only compliance commitment by senior management, including senior executives and the board of directors, but also the commitment of “adequate resources” to compliance. The conduct of supplier audits should not be cursory but rather should be the type of review that is likely





to catch issues even by suppliers who might be taking steps to hide their violations. With OFAC and Customs taking concrete steps to enforce these newer supply-side regulations, it is important that companies that source from and operate abroad use risk-based principles to identify areas of primary risk and use this risk assessment to guide their audit teams to conduct appropriate audits.

The importance of monitoring the supply chain for potential forced labor is reinforced by new legislation, effective June 21, 2022, which bans imports of all goods made in whole or in part from any good from the Xinjiang Uyghur Autonomous Region (“XUAR”) in China. This occurs pursuant to the Uyghur Forced Labor Prevention Act (“UFLPA”), which deems all goods mined, produced, or manufactured in the XUAR to be produced by forced labor.

Under the UFLPA, imports of all goods mined, produced, or manufactured wholly or in part in the XUAR, or by entities on the UFLPA Entity List, are presumed to be made with forced labor and cannot enter the United States unless the importer can rebut that presumption. Notably, any goods from China are now under increased scrutiny by Customs, because the Act covers any goods that even “in part” are manufactured using inputs from the XUAR. Because it is common for goods made through Asia to use Chinese components, Customs will be more closely scrutinizing all imports from Asia to determine if they should be seized at the U.S. border.

Customs is emphasizing the importance of U.S. importers of record conducting careful due diligence, effective supply chain management, forced labor compliance checks and audits, and other measures demonstrating that goods originating in China, or even from other countries that use Chinese-origin parts and components, do not come from the XUAR or otherwise benefit from forced labor or human trafficking.

Customs and the Department of Homeland Security have issued two documents to help importers of record follow through on recommended compliance measures:

- Customs has published “U.S. Customs and Border Protection Operational Guidance For Importers,” which lays out both how Customs will apply the rebuttable presumption that products from the XUAR rely on forced labor, what type of evidence can be



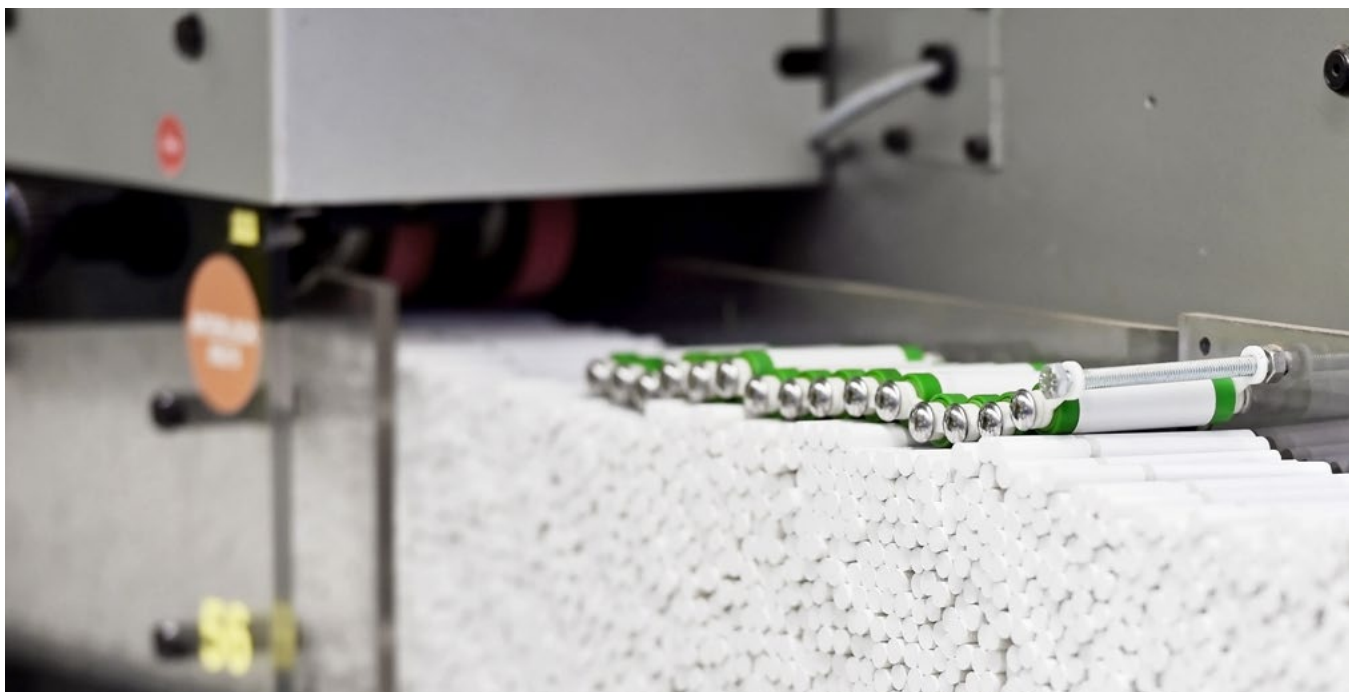
used to rebut the presumption, and how Customs will decide when to seize goods that fail to overcome the presumption. Customs also provides details regarding the due diligence, supply chain tracing, supply chain management, and commodity-specific supply chain tracing documentation that is required. [https://www.cbp.gov/sites/default/files/assets/documents/2022-Jun/CBP\\_Guidance\\_for\\_Importers\\_for\\_UFLPA\\_13\\_June\\_2022.pdf](https://www.cbp.gov/sites/default/files/assets/documents/2022-Jun/CBP_Guidance_for_Importers_for_UFLPA_13_June_2022.pdf).

- The Department of Homeland Security has issued its “Strategy to Prevent the Importation of Goods Mined, Produced, or Manufactured with Forced Labor in the People’s Republic of China,” which details the U.S. Government’s compliance expectations in the areas of due diligence, effective supply-chain tracing, and supply management measures for companies importing from China. [https://www.dhs.gov/sites/default/files/2022-06/22\\_0617\\_fletf\\_uflpa-strategy.pdf](https://www.dhs.gov/sites/default/files/2022-06/22_0617_fletf_uflpa-strategy.pdf).

Notably, Customs has requested 70.3 million for fiscal year 2023 to add enforcement resources to implement this law. As a result, any companies that import should expect aggressive Customs scrutiny of imports from China – and even from Asia in general – to determine whether the goods contain parts and components with a link to the XUAR. Importers accordingly should carefully review their supply chain compliance

measures to ensure that they are compatible with these new legal requirements.

As a final cautionary note, it also is important to note the intersection of these supply-chain-specific requirements with general changes in the OFAC economic sanctions regulations. The invasion of Ukraine, and the response of the United States to implement very strict sanctions on Russia and Belarus, only underscore the importance of the proper management of international supply chains. Russia, in particular, long has been a major supplier of such goods as energy products, aluminum, copper, and other raw materials. Many of these imports are now either blocked for import (e.g., energy products) or can be imported only by scrupulously following the new economic sanctions requirements. Any company that relies on supplies from Russia — even if these goods are not imported into the United States — needs to review carefully all such supply arrangements to ensure their compliance not only with the U.S. import and economic sanctions restrictions but also the coordinated responses of the EU and other governments. All the cautions the U.S. government raises about doing “full spectrum” due diligence apply equally to the new sanctions now in place against Russia and Belarus.



# 2022 Antitrust Outlook for Manufacturers — Significant Changes Under the Biden Administration

*The Biden Administration is pursuing aggressive antitrust law enforcement. This article identifies some issues to watch.*

On July 9, 2021, President Biden issued an executive order on “Promoting Competition in the American Economy.” While directed at various federal agencies and departments, the order specifically calls for “vigorous” antitrust enforcement by our two federal antitrust agencies, the Department of Justice - Antitrust Division (DOJ) and the Federal Trade Commission (FTC). While historically U.S. antitrust enforcement has been marked more by continuity than abrupt change, we are now seeing shifts in agency direction that could affect many businesses and industries, including manufacturers.

## 2022 M&A Related Developments

Merger and acquisition activity by manufacturers is typically high, as firms seek to develop innovative products, expand product portfolios, establish new supply chains (or make vertical acquisitions of vendors and suppliers), and invest in or acquire technologies to position themselves to better compete with each other, as well as with new entrants (often funded by venture capital).

How the antitrust agencies will approach M&A activity among manufacturers could be influenced by the many antitrust changes proposed (or already imposed) under the Biden Administration. These topics include:

- **Possible Changes to the Horizontal and Vertical Merger Guidelines:** President Biden’s executive order on promoting competition called on the FTC and DOJ to “review the horizontal and vertical merger guidelines and consider whether to revise those guidelines.” A subsequent FTC/DOJ press



AUTHOR

Greg Neppi | [gneppi@foley.com](mailto:gneppi@foley.com)

release, dated July 9, 2021, stated that the “current guidelines deserve a hard look to determine whether they are overly permissive.” Speculation abounds as to how the agencies might seek to revise these guidelines. Market share caps, the elimination of the Herfindahl-Hirschman Index (HHI) as a measure of market concentration, and applying a “public welfare” standard (in place of the long-established “consumer welfare” standard) as the antitrust guidepost for identifying anticompetitive mergers have all been proffered by commentators.

Some advocates have argued that a “public welfare” standard should include consideration of a wide range of issues such as effects on labor, corporate governance issues, environmental concerns, racial impacts, and wealth inequality concerns. The FTC reportedly has requested information in merger reviews on topics like unionization, equity, franchising, and environmental, social, and governance issues (ESG), which would appear unrelated to traditional antitrust considerations and the “substantially lessen competition” standard for merger challenges set forth by statute in Section 7 of the Clayton Act.

Such an expansion of the cognizable issues relevant to merger reviews could *substantially* alter the predictability of agency merger enforcement efforts. Such revisions, if made — or even if applied by the antitrust agencies informally, as an exercise in agency “enforcement discretion” — could mark



a change in merger enforcement, with impacts on strategic planning, business confidence, and business valuations.

- **Vertical Merger Guidelines Withdrawn by the FTC:** In September 2021, the FTC voted unilaterally to withdraw its approval of the Vertical Merger Guidelines adopted jointly by the FTC and DOJ in June 2020. (To date, DOJ has not similarly withdrawn its approval of these guidelines.) The utility of this agency enforcement guidance to businesses and the antitrust bar is therefore in question, at least in transactions pending FTC review.
- **FTC “Informal Interpretations” of HSR Rules are Under Review.** For decades the FTC’s Premerger Notification Office (PNO) has provided regular informal guidance to the antitrust bar on interpreting and applying the merger notification rules set forth in the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (HSR) and implementing regulations. In a blog post dated August 26, 2021, however, the FTC’s Bureau of Competition stated a concern that these “informal interpretations may not reflect modern market realities or the policy position of the Commission.”<sup>1</sup> While HSR informal guidance is still available, the blog post noted that the FTC is “currently in the process of reviewing the voluminous log of informal interpretations to determine the best path forward.”
- **FTC “Warning Letters”:** The FTC announced in August 2021 that it may send letters to parties to transactions under FTC investigation stating that, despite imminent expiration of the HSR waiting period, the FTC investigation remains open, and if the parties choose to close the transaction, they are “doing so at their own risk.” The legal significance of such a warning letter in any subsequent FTC challenge to a consummated transaction has yet to be tested. At a minimum, however, such letters may inject deal uncertainty by potentially delaying closings and extending the timeframe for deal reviews beyond the statutory waiting period established by the HSR Act.

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1. Reforming the Pre-Filing Process for Companies Considering Consolidation and a Change in the Treatment of Debt, Federal Trade Commission, August 26, 2021, <https://www.ftc.gov/enforcement/competition-matters/2021/08/reforming-pre-filing-process-companies-considering-consolidation-change-treatment-debt> (Last Accessed May 25, 2022).





- **Antitrust Concerns with “Technology” Acquisitions:** President Biden’s executive order on promoting competition cited “dominant tech firms” as “undermining competition and reducing innovation” through “killer acquisitions,” including the acquisition of “nascent competitors.” While primarily focused on technology acquisitions by “Big Tech” platforms, this technology acquisition concern *could* apply to other industries. As cutting-edge technology becomes increasingly important to many manufacturing businesses, technology acquisitions could receive greater agency scrutiny.

## 2022 Additional Antitrust Developments

Changes under the Biden Administration extend beyond M&A. Some of these include:

- **Antitrust Concerns with “Labor Markets”:** Many manufacturing businesses are labor intensive, and the Biden Administration has signaled that “labor markets” are a topic of high antitrust interest. The FTC and DOJ have recently held a number of workshops addressing competition issues affecting labor markets and the welfare of workers. Topics discussed included labor monopsony; the use of restrictive clauses in labor agreements, including non-competes and non-disclosure agreements; information sharing and benchmarking activity among competing employers; and the relationship between antitrust law and collective bargaining efforts in the “gig economy.” Employee non-competes were a particular focus of these workshops. DOJ has (even prior to the Biden Administration) pursued companies engaged in employee “no-poach” agreements, sometimes as a *criminal* antitrust violation. Manufacturers will want to follow Biden Administration labor policy changes, including the possible use of *antitrust law* to effectuate labor policy changes.
- **Antitrust Interest in Supply Chain Disruptions:** Many manufacturers have complex supply chains. On November 29, 2021, the FTC voted to conduct a study of whether and how the supply chain interruptions of the past year have affected competition. The study will look to answer two central questions that may be of interest to manufacturers: (i) why these disruptions occurred and (ii) whether they are leading to specific “bottlenecks, shortages, anticompetitive practices, or contributing to rising consumer prices.” According to the FTC announcement, an order for detailed information will be sent to nine large retailers, wholesalers, and



consumer good suppliers in the United States. That said, the FTC certainly could expand this probe to include other companies, including manufacturers in various industries.

■ **Authorizations for FTC Antitrust Investigations:**

In July and September 2021, the FTC — through some 15 resolutions — authorized a compulsory process for FTC investigations over a wide range of antitrust topics, including proposed and consummated mergers, suspected monopolization, and suspected abuse of intellectual property. Under these resolutions, a *single* FTC commissioner may authorize FTC staff attorneys to issue compulsory process (such as civil investigative demands and subpoenas). Previously, such prior delegations applied virtually exclusively to consumer protection investigations, as opposed to antitrust investigations.

With full Commission oversight of antitrust investigations rescinded, there may be “less accountability and more room for mistakes, overreach, cost overruns, and even politically-motivated decision making,” according to FTC Commissioners Phillips and Wilson in their dissenting statement of September 14, 2021.<sup>2</sup> Whether and how this lowering of the threshold for the FTC to launch antitrust investigations could affect manufacturers is unknown, but it does reflect a change worth considering. As both the FTC and DOJ have authority to review and challenge consummated deals — even deals that were notified and received HSR clearance — one possible outcome of these resolutions is to increase the number of investigations of consummated transactions.

- **Criminal Prosecution of Monopolists?** While *potentially* criminal, DOJ has, in recent history, pursued monopolization cases civilly under Section 2 of the Sherman Act, and reserved criminal prosecutions for cartel conduct challenged under Section 1 of the Sherman Act. Nevertheless, Deputy Assistant Attorney General Richard Powers stated on March 2, 2022 that DOJ is prepared to bring criminal charges for monopolization “if the facts and the law lead us to the conclusion that a criminal

charge based on a Section 2 violation is warranted.” Were DOJ to pursue this path, it would reflect a *substantial* change to DOJ’s criminal antitrust enforcement practices.

### **The Continuing Risks from Cartel Conduct**

The developments discussed above are largely driven by the Biden Administration, although one antitrust risk that transcends administration changes and partisan lines is cartel conduct. We cannot forget the lessons of DOJ’s long-running investigation of auto parts suppliers, one of the largest criminal investigations ever pursued by its Antitrust Division, which resulted in charges against some 48 companies and yielded almost \$3 billion in criminal fines. Settlements of class action and other private plaintiff claims reportedly exceeded \$1 billion.

While DOJ’s Antitrust Division has long pursued both companies and individuals criminally in cartel cases, the Biden Administration’s Deputy Attorney General Lisa Monaco announced in October 2021 that DOJ would enhance efforts to charge individuals in white-collar prosecutions. You may recall the famous “Yates memo” from 2015 — issued by then Deputy Attorney General Sally Yates — announcing stepped-up efforts to prosecute individuals. The October 2021 announcement appears to renew and reinvigorate this focus on prosecuting individuals.

Manufacturers may have little control over Biden Administration-initiated changes to the merger and non-merger enforcement policies discussed above. An effective antitrust compliance program, however, can pay real dividends by detecting and deterring cartel conduct. Though DOJ historically did not give credit for antitrust compliance programs in making charging decisions and sentencing recommendations, it announced changes to both policies in July 2019. These changes increase the legal benefits of implementing an effective antitrust compliance program.

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2. Dissenting Statement of Commissioners Noah Joshua Phillips and Christine S. Wilson Regarding the Issuance of Eight Omnibus Resolutions, U.S. Federal Trade Commission, Sep. 14, 2021, [https://www.ftc.gov/system/files/documents/public\\_statements/1596256/p859900njpcswomnibusdissent.pdf](https://www.ftc.gov/system/files/documents/public_statements/1596256/p859900njpcswomnibusdissent.pdf) (Last Accessed May 25, 2022).

# The Latest Patent Developments in China: What Manufacturers Need to Know

## Introduction

For companies that sell in China, manufacture in China, or face competitors manufacturing in China, Chinese patents are an increasingly crucial element of a strong patent portfolio. While many manufacturers have announced plans to diversify their supply chains away from China in view of persistent disruptions during the COVID-19 pandemic, those efforts have been slow to materialize. In the meantime, China continues to experience explosive growth in both patent filings and enforcement proceedings, far outpacing the U.S. This increase is driven by both the continued reliance on Chinese operations in global supply chains and by concerted efforts of Chinese lawmakers to strengthen patent rights and increase consistency in enforcement proceedings. This article summarizes those recent efforts at both the China National Intellectual Property Administration and in the Chinese court system.

## Patent Filing Trends in China

China offers three distinct types of patent protection: invention patents, utility models, and industrial designs.

The invention patent is analogous to a U.S. utility patent. It is subject to a rigorous examination process for both novelty and inventive step, which can take 2–5 years to complete, and has a 20-year term.

The utility model has no equivalent in the U.S. and is often overlooked by U.S. manufacturers when setting filing strategies. It is subject to a shortened examination process for novelty only, typically grants in 6–12 months, and has a 10-year term. It requires lower filing fees and annuities, and is harder to invalidate due to its lower inventiveness requirement.



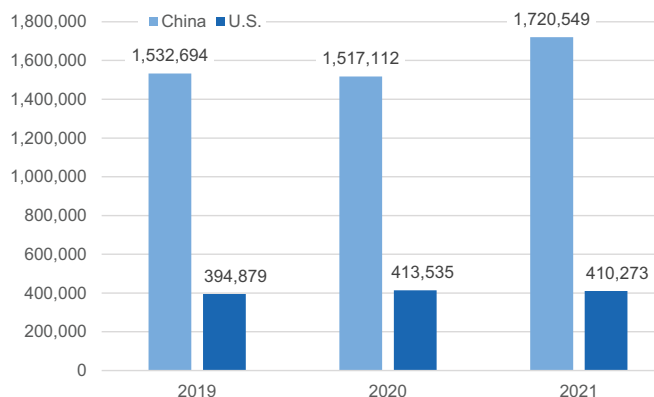
## AUTHORS

Chase Brill | [cbrill@foley.com](mailto:cbrill@foley.com)

Roberto Fernandez | [rfernandez@foley.com](mailto:rfernandez@foley.com)

The industrial design is similar to a U.S. design patent, covering only the outward appearance of an article of manufacture, and has a 15-year term (extended from 10 years in June of 2021).

Like U.S. utility applications, Chinese invention applications are typically published 18 months after filing. Examination of the numbers of Chinese invention patents published reveals a sharp increase in 2021 compared to both 2020 and 2019. This increase was not replicated in the U.S., which instead remained stagnant.



**Figure 1: Number of Invention/Utility Patent Applications Published per Year**

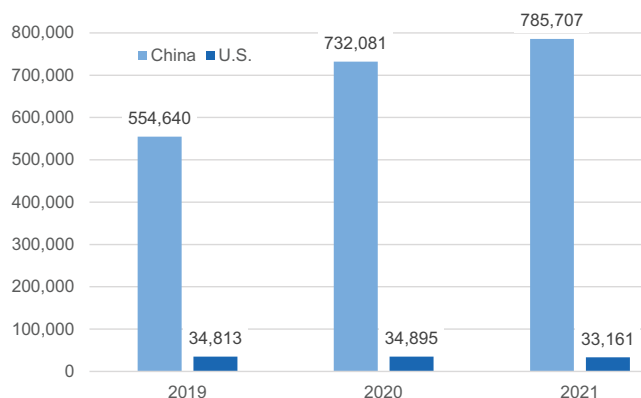
(Source: TotalPatent One®)



While U.S. publications decreased in 2021, Chinese publications rose more than 13%. Of course, due to the 18-month publication delay, these numbers reflect 2019 application filings, and it is likely that 2022 publication numbers will decrease due to the start of the COVID-19 pandemic in 2020.

Utility models, however, saw no such slowdown. The number of utility models *granted* ballooned from about 2.4 million in 2020 to over 3.1 million in 2021. The 2021 numbers reflect 2020 filings, meaning that the number of utility model filings increased *in spite* of the pandemic. Whether this represents an overall increase in patent filings or instead a shift from invention applications to utility model applications (e.g., as a cost-savings measure due to reduced 2020 IP budgets) is yet to be seen. Either way, utility models merit serious consideration for manufacturers, particularly those whose products have lower lifespans.

The increased activity in China also extends to design patents. In 2021, the number of design patents granted in China was nearly 24 times the number granted in the U.S.



**Figure 2: Number of Design Patents Granted per Year**  
(Source: TotalPatent One®)

China's recent changes to design patent laws, such as increasing the design patent term from 10 years to 15 years, likely signals that China's dominance in design patent filings will continue in 2022 and beyond. Importantly, manufacturers should not fall for the misconception that design patents are limited to consumer products; on the contrary, design patents are available on any products, regardless of where they fall within the overall manufacturing process, and regardless of whether they are visible to the end

consumer. They are particularly useful to prevent knockoffs, which remain a pervasive problem in China. And aside from being enforceable in Chinese courts, design patents can be used to facilitate takedowns on Alibaba and Amazon, substantially adding to their value.

### Trends in Patent Enforcement in China

The rapid increase in Chinese patent filings has been accompanied by a similar increase in patent enforcement. China's efforts to strengthen patent rights may have encouraged manufacturers to engage in more enforcement in China while also fueling the filing of additional patent applications to create future enforcement opportunities. Another factor likely driving increased enforcement and filings is the recent change to Chinese patent laws, which provides for up to quintuple damages for intentional infringement, increased statutory damages from 1 million yuan to 5 million yuan (approximately \$780,000 USD), and an increase in the statute of limitations from two years to three years.<sup>1</sup> Whatever the reason, the opportunity for enforcement in China looks entirely different than it did a decade ago.

In 2019, China created the IP Tribunal, focused on centralizing appeals of decisions regarding most IP disputes and serving a function somewhat analogous to the U.S. Court of Appeals for the Federal Circuit. The Tribunal is a focal point of China's policy changes, intended to improve the quality of IP protection and standardize enforcement by providing specialized judges for hearing disputes. Indeed, all of the judges have at least a master's degree in a science field, and over 30% hold PhDs.

After completing its three-year pilot program, China has continued to invest in the Tribunal and heralds its development as deepening reform in IP protection. Of the nearly 2,600 newly-received non-administrative cases in 2021, 22% were for disputes involving invention patents and 31% were for disputes involving utility model patents.<sup>2</sup>

1. Decision of the Standing Committee of the National People's Congress on Amending the Patent Law of the People's Republic of China, Xinhua News Agency, October 18, 2020, [http://www.gov.cn/xinwen/2020-10/18/content\\_5552102.htm](http://www.gov.cn/xinwen/2020-10/18/content_5552102.htm) (Last Accessed May 20, 2022).

2. Annual Report of the Intellectual Property Tribunal of the Supreme People's Court (2021), Intellectual Property Court of the Supreme People's Court, February 28, 2022, <https://ipc.court.gov.cn/zh-cn/news/view-1783.html> (Last Accessed May 20, 2022).

Similar to the interplay between patent law and antitrust law in the U.S., Chinese patent disputes often involve “monopoly” laws. Monopoly cases continue to see heightened importance in China. In 2021, the Tribunal decided a case where it ruled that a settlement agreement to a patent infringement lawsuit was not narrowly tailored to the infringement dispute and instead extended to activities that were intended to restrict and exclude market competition.<sup>3</sup> In reaching this conclusion, the Tribunal held that the agreement contained restrictions that had nothing to do with the scope of protection of the patent in question. The takeaway from this case is that patent agreements in China are likely to come under increased scrutiny from an anti-monopoly perspective and should be intentionally focused on the scope of protection provided by the patents at issue. Manufacturers with IP agreements in China would be wise to review them in light of this decision.

Aside from administrative and judicial arenas, Chinese patents can also be enforced in a specialized system created by Alibaba, the Chinese e-commerce giant.

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3. (2021) Supreme Court Zhimin Zhong No. 1298; Supreme People’s Court of the People’s Republic of China; Civil Judgment, Intellectual Property Court of the Supreme People’s Court, March 21, 2022, <https://ipc.court.gov.cn/zh-cn/news/view-1873.html> (Last Accessed May 20, 2022).

This system requires a patent owner to register its rights on Alibaba and then file a complaint identifying infringement occurring on Alibaba. In 2021, more than 640,000 trademarks, copyrights, and patents were registered on Alibaba.<sup>4</sup> While Alibaba did not release how many of these were patents, the significant usage of Alibaba across all IP warrants consideration by patent owners.

### What to Watch for in 2022 and Beyond

As in most legal arenas, the landscape in China’s patent system is constantly shifting, and the next few years look to be action packed. First, the coming months will see the continued development of an ongoing dispute at the World Trade Organization (WTO), between China and the European Union (EU), regarding the ability of Chinese courts to influence proceedings in other countries by assessing fines on the parties.<sup>5</sup> The EU has taken issue with China’s policy of “prohibit[ing] patent holders from asserting

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4. 2021 Annual Report on Intellectual Property Protection, Alibaba Group, <https://files.alicdn.com/tps/service/8f603e2d95fbb318d22a7315c9833e80.pdf> (Last Accessed May 20, 2022).

5. Request for Consultations by the European Union, February 18, 2022, [https://trade.ec.europa.eu/doclib/docs/2022/february/tradoc\\_160051.pdf](https://trade.ec.europa.eu/doclib/docs/2022/february/tradoc_160051.pdf) (Last Accessed May 20, 2022).





their rights in other jurisdictions by commencing, continuing or enforcing the results of legal proceedings before a non-Chinese court.” According to a Request for Consultations issued to China by the European Union, “[t]he prohibition materialises through Chinese courts issuing so called ‘anti-suit injunctions’ enforced through daily penalties in case of infringement . . . .” Critics argue that China implemented this policy in order to shackle litigants to Chinese courts, which can provide unfair advantages to Chinese entities. Proponents argue that the policy ensures the integrity of the Chinese courts to resolve disputes without fear of forum shopping. A response from China is due at the WTO in the coming weeks. Unless this policy changes, Chinese patent holders are likely to consider the benefit of enforcement in China at the risk of being precluded from enforcement outside of China.

China also recently joined WIPO’s Hague system for the International Registration of Industrial Designs, making it possible for an applicant to obtain design rights in China and other Hague countries using a single application. With the prolific nature of design patent application filings in China, the Hague system could soon see a radical uptick in usage.

2022 also marks the effective start of the Regional Comprehensive Economic Partnership (RCEP) — a Free Trade Agreement between China, India, Australia, New Zealand, Vietnam, Cambodia, Myanmar, Japan, South Korea, Thailand, Malaysia, the Philippines, Indonesia, Brunei, Laos, and Singapore — forming the largest trading bloc by total global domestic product.<sup>6</sup> While deferring to the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement, the RCEP includes extensive IP provisions, one of which being that “each Party shall provide that any person may do an act that would otherwise infringe a patent if the act is done for experimental purposes relating to the subject matter of a patented invention.”<sup>7</sup> The development of this and other provisions of the RCEP in the years to come is likely to have a significant impact on global IP strategy.

China’s National Intellectual Property Administration (CNIPA) has proposed revised examination guidelines for implementing the amended patent laws,<sup>8</sup> and a decision on the revisions may come in 2022.

The proposals include:

- Eliminating the 15-day mail delay “grace period” for deadlines to respond to communications from CNIPA;
- Permitting delayed examination of a design patent application for up to 36 months;
- Permitting examiners to require submission of a video file showing animation of a graphical user interface claimed in a design patent application;
- Implementing inventiveness examination (in addition to the current novelty examination) in utility model applications;
- Precluding utility models from receiving patent term adjustment (PTA), which became available to utility models under the amendment to the patent law entered in 2021 (albeit in limited circumstances);
- Precluding PTA for invention patents filed simultaneously with utility model applications; and
- Delaying examination of an invention application that is filed simultaneously with a utility model application.

These revisions to the examination guidelines, combined with the other upcoming changes discussed above, indicate that 2022 will be a year of change in Chinese practice. Manufacturers would be wise to stay abreast of these issues and others so as to maximize the value of their global patent portfolio.

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6. RCEP: Asia-Pacific Countries Form World’s Largest Trading Bloc, BBC, November 16, 2020, <https://www.bbc.com/news/world-asia-54949260> (Last Accessed May 20, 2022).

7. Regional Comprehensive Economic Partnership (RCEP) Agreement, Article 11.40 (November 15, 2020).

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8. Notice on Public Solicitation of Comments on the Draft Revised Guidelines for Patent Examination (Draft for Comments), China National Intellectual Property Administration, August 3, 2021, [https://www.cnipa.gov.cn/art/2021/8/3/art\\_75\\_166474.html](https://www.cnipa.gov.cn/art/2021/8/3/art_75_166474.html) (Last Accessed May 20, 2022).

# Subscription Model Regulation Trends and Takeaways

Subscriptions are an indispensable tool for recurring-revenue business models, including among clients in the manufacturing sector offering product or service subscriptions, yet their growing popularity has been a target for regulators and litigants alike. 2022 is poised to continue shaping this emerging landscape, featuring further regulatory frameworks, federal and state enforcement, and continued potential for private litigation. Keeping a pulse on the shifting regulatory framework and main consumer protection themes in this space can help manufacturing companies with subscription model offerings prepare for the road ahead.

## Federal Regulatory Framework for Subscription Models

Recent developments from the Federal Trade Commission (FTC), including an [enforcement policy statement](#) and [press release](#), signal an intent to escalate enforcement activity against subscription auto-renewal offerings, more formally referred to as “negative options.” Negative options include offerings where there is a “term or condition under which the seller may interpret a consumer’s silence or failure to take affirmative action to reject a good or service or to cancel the agreement as acceptance or continuing acceptance of the offer.” The FTC categorizes some of these offerings as “illegal dark patterns that trick or trap consumers into subscription services.” While recognizing that assessments are individualized, the FTC has provided basic guidelines for avoiding “illegal dark patterns,” including:

- Clearly and conspicuously disclosing material terms, including the existence of the negative option offer, the offer’s total cost, and how to cancel the offer;
- Disclosing these material terms before consumers agree to the purchase;
- Obtaining consumers’ express informed consent to such offers; and
- Avoiding unreasonable barriers to cancellation.



### AUTHORS

Kendall Waters | [kwaters@foley.com](mailto:kwaters@foley.com)

Erik Swanholt | [eswanholt@foley.com](mailto:eswanholt@foley.com)

Recent FTC enforcement actions provide more guidance on how manufacturing companies can implement compliant negative option features. In the late spring of 2022, the FTC announced a settlement with an online platform based, in part, on the company’s provision of subscription plans that were difficult to cancel. While case-specific, that settlement order again underscored key compliance features approved by the FTC. Consumers’ affirmative consent should be obtained separately from any other consent. For online and written offerings, the consumer must affirmatively accept the negative option feature (including by check box, signature, or another comparable method). For disclosures to be “clear and conspicuous,” companies should give disclosures, in the same manner as the original communications, which are easily noticeable, unavoidable, and understandable. While companies should provide order confirmation for the renewed subscription, that notice should contain only the essentials and should not include marketing materials. To make cancellations easy, consumers who subscribed orally should not be placed on hold by customer service for more than 10 minutes, and companies should return any consumer’s voicemail within one business day.



## Developments for State Regulation of Subscription Models

In line with federal guidance, state auto-renewal laws increasingly require businesses to notify consumers clearly and conspicuously about what consumers are signing up for, obtain consumer's affirmative consent to subscribe, provide acknowledgment of the order, and offer a simple means of cancellation. However, the evolving patchwork of state statutes often impose unique and changing requirements on consumer-facing businesses, including manufacturing companies offering product or service subscription models. The following states have recently enacted new or revised auto-renewal statutory frameworks:

**California:** California has new requirements for its auto-renewal laws that will take effect in mid-2022. California already required "clear and conspicuous" notice of the subscription offer's terms, a consumer's affirmative consent to those terms, and a straightforward means for cancellation.

The amended law introduces reminder notice and online termination requirements and goes into effect on July 1, 2022.

In certain instances, companies must send reminder notices that clearly and conspicuously state the following:

- The subscription will automatically renew *unless* the consumer cancels;
- The length of the renewal period and any additional terms;
- Methods for consumer cancellation;
- For electronic notice, either a link to cancel or another reasonably accessible electronic method to facilitate cancellation; and
- Company's contact information.

For *free trial periods longer than 31 days*, generally a company must send the consumer a reminder notice **between 3 and 21 days before the end of the trial period.**

For a *subscription with an initial term of one year or more*, the company must send the consumer a reminder notice **between 15 and 45 days before the end of the initial term.**





For online termination, the online cancellation method must allow cancellation at will and *without engaging in any further steps that hinder or delay the consumer's ability to terminate immediately*. This requirement is more stringent than those in other jurisdictions. Companies should offer at least one of the following: (1) a “prominently located direct link or button,” or (2) a pre-written and immediately accessible termination email that a consumer can send to the company without having to add information.

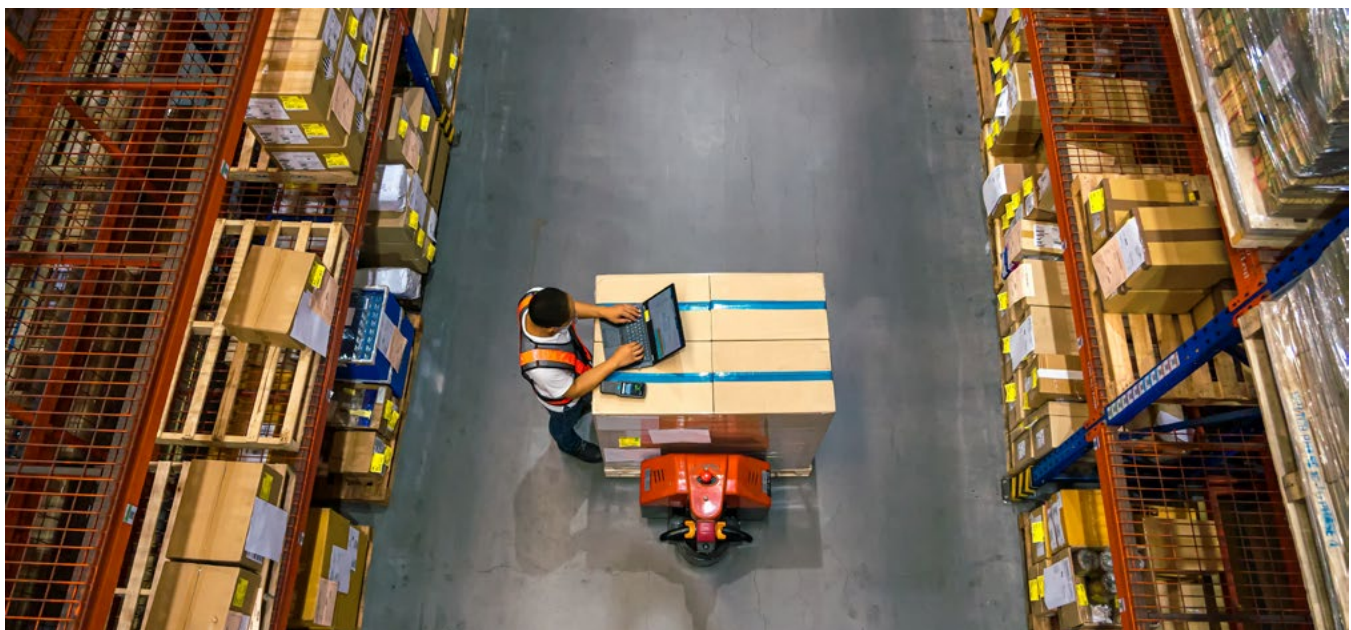
**Colorado:** Colorado’s recent law also requires clear and conspicuous terms; a written acknowledgment with the offer terms, cancellation policy, and cancellation guidance; and a simple means for cancellation. Businesses must include an online link that provides consumers with detailed automatic renewal offer information.

**Delaware:** Delaware’s law applies where negative option programs have an initial term of one year or more, with a renewal period of at least one month. Delaware requires clear and conspicuous terms, including disclosure of automatic renewal terms, renewal reminders, and a simple means for cancellation. Before filing any lawsuit, Delaware requires consumers to give notice to the seller and an opportunity to cure.

**Illinois:** Illinois’s statutory regime now applies to all automatic renewal programs rather than just annual programs. Illinois requires notice, cancellation, and affirmative consent requirements comparable to other states’ requirements.

**Idaho:** Effective January 2023, Idaho will impose certain notice and cancellation requirements for subscriptions with a term of 12 months or longer. Idaho requires clear and conspicuous disclosure of automatic subscription renewal terms and cancellation methods. Cancellation methods must include free online cancellation of the subscription and cancellation in the same manner that the consumer used to subscribe. Businesses must provide consumers with a renewal notice 30-to-60 days in advance of renewal, which must describe the goods, state the price, inform the consumer regarding renewal, and provide at least two cancellation methods.

**Virginia:** Virginia now requires clear and conspicuous disclosures before the renewal terms for automatic renewals, the consumer’s affirmative consent to the agreement containing the automatic renewal offer terms before charging the consumer, and an acknowledgment of the automatic renewal or continuous service offer terms, cancellation policy, and information regarding how to cancel in a manner that is capable of being retained by the consumer.







### **Auto-Renewal Subscription Litigation Trends**

As state legislatures direct more attention to enacting and amending auto-renewal laws, private litigants have followed suit. This includes costly class action litigations and settlements against companies offering subscription models for either products or services. However, other companies have avoided consumer auto-renewal litigation successfully at the motion to dismiss phase, establishing that the company provided requisite notice as a matter of law. While this strategy was effective with less-defined statutory requirements and less-robust case law, this strategy may prove increasingly difficult as states provide granular statutory requirements for compliance. More stringent and pervasive state regulations, and increasing FTC guidance, are creating a new landscape for litigators to navigate, and consumers may have more tools available to plausibly allege claims.

### **Key Subscription Model Regulation Takeaways**

Clarity, consent, and convenience are prominent features for model subscription programs. The FTC's enforcement policy statement and recent settlement order are helpful frameworks for manufacturing companies offering product or service subscription models. Nationwide companies should consider regulatory schemes in high-impact states like California, which not only has a considerable consumer population but traditionally is also a forerunner in the consumer protection space. Businesses with a more targeted reach should also consider relevant statutory requirements in their key states. Some credit card companies, like MasterCard, are also starting to impose notice requirements on private companies. Government regulations and private actor requirements continue trending toward conspicuous and clear disclosures and consent.

# Contributors

For more information on emerging legal and business developments for the manufacturing industry, please contact:



**Chase Brill**  
Partner  
Washington, D.C.  
[cbrill@foley.com](mailto:cbrill@foley.com)



**Brooke Clarkson**  
Partner  
Washington, D.C.  
[bclarkson@foley.com](mailto:bclarkson@foley.com)



**Nicholas Ellis**  
Partner  
Detroit  
[nellis@foley.com](mailto:nellis@foley.com)



**Roberto Fernandez**  
Associate  
Chicago  
[rfernandez@foley.com](mailto:rfernandez@foley.com)



**Jon Gabriel**  
Partner  
Boston  
[jgabriel@foley.com](mailto:jgabriel@foley.com)



**Alejandro Gomez-Strozzi**  
Partner  
Mexico City  
[agomez@foley.com](mailto:agomez@foley.com)



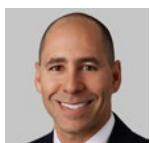
**Greg Husisian**  
Partner  
Washington, D.C.  
[ghusisian@foley.com](mailto:ghusisian@foley.com)



**Dan Kaplan**  
Partner  
Madison  
[dkaplan@foley.com](mailto:dkaplan@foley.com)



**Michael Kirwan**  
Partner  
Jacksonville  
[mkirwan@foley.com](mailto:mkirwan@foley.com)



**Jeffrey Kopp**  
Partner  
Detroit  
[jkopp@foley.com](mailto:jkopp@foley.com)



**Michelle Ku**  
Partner  
Dallas  
[mku@foley.com](mailto:mku@foley.com)



**John Lanza**  
Partner  
Boston  
[jlanza@foley.com](mailto:jlanza@foley.com)



**David Levintow**  
Associate  
Washington, D.C.  
[dlevintow@foley.com](mailto:dlevintow@foley.com)



**Vanessa Miller**  
Partner  
Detroit  
[vmiller@foley.com](mailto:vmiller@foley.com)



**Greg Neppi**  
Partner  
Washington, D.C.  
[gneppi@foley.com](mailto:gneppi@foley.com)



**Charlie Niemann**  
Associate  
Milwaukee  
[cniemann@foley.com](mailto:cniemann@foley.com)



**Felicia O'Connor**  
Senior Counsel  
Detroit  
[foconnor@foley.com](mailto:foconnor@foley.com)



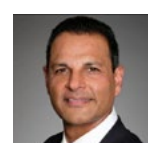
**Eric Pearson**  
Partner  
Milwaukee  
[epearson@foley.com](mailto:epearson@foley.com)



**Kristin McGaver Sikora**  
Associate  
Milwaukee  
[ksikora@foley.com](mailto:ksikora@foley.com)



**David Simon**  
Partner  
Milwaukee  
[dsimon@foley.com](mailto:dsimon@foley.com)



**Jaikaran Singh**  
Partner  
San Diego  
[jsingh@foley.com](mailto:jsingh@foley.com)





**Sarah Slack**  
Partner  
Madison  
[sslack@foley.com](mailto:sslack@foley.com)



**Amanda Soler**  
Associate  
Dallas  
[asoler@foley.com](mailto:asoler@foley.com)



**Gary Solomon**  
Partner  
Dallas  
[gary.solomon@foley.com](mailto:gary.solomon@foley.com)



**Erik Swanholt**  
Partner  
Los Angeles  
[eswanholt@foley.com](mailto:eswanholt@foley.com)



**Pete Tomasi**  
Of Counsel  
Milwaukee  
[ptomasi@foley.com](mailto:ptomasi@foley.com)



**John Turlais**  
Special Counsel  
Milwaukee  
[jturlais@foley.com](mailto:jturlais@foley.com)



**Hillary Vedvig**  
Associate  
Madison  
[hvedvig@foley.com](mailto:hvedvig@foley.com)



**Rohan Virginkar**  
Partner  
Washington, D.C.  
[rvirginkar@foley.com](mailto:rvirginkar@foley.com)



**Kendall Waters**  
Associate  
Los Angeles  
[kwaters@foley.com](mailto:kwaters@foley.com)



**Sandy Winer**  
Partner  
Washington, D.C.  
[swiner@foley.com](mailto:swiner@foley.com)

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