

# Protecting Your Bottom Line

## ADJUSTING SUPPLY CHAIN CONTRACTS TO MITIGATE TARIFF IMPACTS

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Recent shifts in international tariff policies have created significant uncertainty for U.S. importers. As trade tensions fluctuate and new regulations merge, businesses face potentially substantial cost increases that can erode profit margins overnight. For U.S. buyers, revisiting your supply contracts now can help safeguard your business from unexpected costs and disruptions. This article outlines practical contract adjustments to consider in today's dynamic and uncertain trade environment.

### PRICE ADJUSTMENT CLAUSES

When tariffs increase suddenly, someone must bear the additional cost. Without specific contractual language addressing this issue, suppliers often attempt to pass on the entire burden to buyers through price increases.

#### Consider adding:

- Tariff-specific price adjustment provisions.
- Formulas that automatically adjust pricing when tariffs change (e.g., " $\text{Adjusted Price} = \text{Base Price} \times [1 + (\text{Current Applicable Tariff Rate} - \text{Baseline Tariff Rate})]$ ").
- Caps on how much price can increase due to tariff change (e.g., "*In the event of new or increased tariffs exceeding 5% of the Product Value, Seller may adjust prices proportionally to reflect these costs, provided that total price increases shall not exceed 15% within any 12-month period...*").
- Limits on adjustment frequency.

It is essential to review the pricing formulas regularly and to ensure they remain fair and relevant as market conditions evolve. We suggest that contracting parties include a mutual review clause (e.g., "*If tariffs affecting the Products increase or decrease by more than 10% during any 6-month period, the parties shall meet within 5 business days to negotiate in good faith an equitable adjustment to pricing.*").

### FLEXIBLE PAYMENT TERMS

Cash flow management becomes critical when tariff costs rise unexpectedly. Adjusting payment terms can provide breathing room while your business adapts to new market conditions.

#### Options to explore:

- Extended payment windows when tariffs increase (e.g., net 60 instead of net 30).
- Tariff-triggered payment deferrals (e.g., "*If a new tariff is imposed exceeding 10% on products covered by this agreement, buyer may defer 50% of the payment for 45 days without penalty.*").
- Percentage-based triggers (e.g., "*If tariffs rise by more than 10%...*").
- ACH Debit payments with U.S. Customs, which can provide up to 10 extra days to pay duties, taxes, and fees on certain types of merchandise, including quota goods. More information can be found at: <https://www.cbp.gov/trade/basic-import-export/automated-clearinghouse-ach>.

When tariffs suddenly increase, cash flow challenges arise for importers who must pay both the product costs and higher tariffs. Extended payment terms give buyers more time to manage these increased costs while maintaining their supply chain and adjusting pricing strategies.

### STRATEGIC INCOTERM

Incoterms (International Commercial Terms) define who handles shipping, insurance, customs, and tariffs in international transactions. It is important to know that these standardized terms can shift risk and responsibility between the parties.

- **Current EXW (Ex Works)?** Consider negotiating toward DDP (Delivery Duty Paid), which shifts tariff responsibility to the seller.
- **Can't secure DDP?** Look at balanced alternatives like DAP (Delivered at Place), CPT (Carriage Paid To), or CFR (Cost and Freight).
- Work with customs brokers to model different scenarios and optimize entry points.

For example, under EXW terms, the U.S. buyer bears all responsibilities from the moment goods leave the seller's facility, including all import duties and tariffs. In contrast, DDP requires the seller to deliver goods to the specified designation with all duties and tariffs paid – a significant difference that determines who absorbs unexpected tariff increases. For a balanced approach, parties can agree on DAP, which requires the seller to pay all costs and suffer

any potential losses of moving goods sold to a specific location. Under DAP agreements, the seller takes on all the risks and costs associated with delivering goods to an agreed-upon location, including packaging, documentation, export approval, loading charges, and ultimate delivery. Once the shipment arrives at the specified destination, the buyer assumes all the risk and responsibility for unloading the goods and clearing them for import.

### ENHANCED FORCE MAJEURE PROVISIONS

Force majeure clauses are designed to protect parties when unforeseeable circumstances make it impossible or impractical to fulfill contract obligations. Standard force majeure clauses typically cover events like natural disasters, wars, and other "acts of God" but often don't adequately address tariff changes. Courts typically tend to view tariff changes as foreseeable business risks rather than extraordinary events. This means that without specific language, a company might not be able to invoke traditional force majeure protection without specific language. Consider strengthening yours by:

- Explicitly listing "significant tariff increases" as qualifying events.
- Define what constitutes "significant" (e.g., "tariff increases exceeding 50% of pre-existing rates").
- Including graduated response options based on the severity of the tariff increase percentage, beyond simple termination.
- Documenting financial impacts and mitigation efforts (e.g., sourcing from alternative suppliers, redesigning products).

### SAMPLE STAGED RESPONSE FRAMEWORK BASED ON TARIFF SEVERITY

#### Tier 1: Moderate Tariff Increase (10-25% increase)

##### Response Mechanisms:

- Supplier and buyer share the tariff impact equally (50/50 split).
- Payment terms extended by 15 additional days.
- No minimum order quantity requirements for 90 days.

#### Tier 2: Substantial Tariff Increase (26% - 50% increase)

##### Response Mechanism:

- Buyer pays 25% of increased tariff costs, supplier absorbs 75%.
- Temporary 5% price discount on affected products.
- Payment terms extended by 30 ad-

ditional days.

- Option to substitute comparable products from non-tariffed origins.

#### Tier 3: Severe Tariff Increase (51% -75% increase)

##### Response Mechanism

- Contract performance is partially suspended for affected products.
- Required purchase volumes reduced by 40%.
- Mandatory 30-day renegotiation period with executive-level participation.
- Expedited approval process for substitute products from alternative origins.
- Buyer has the right to dual source affected products without exclusivity penalties.

#### Tier 4: Critical Tariff Increase (76% increase)

##### Response Mechanisms:

- Right to terminate affected product lines with 30 days' notice.
- Mandatory exploration of manufacturing relocation options.
- Requirement to maintain non-affected product lines for at least 180 days.
- Cooperation on any applicable tariff exclusion requests.

This graduated response framework transforms force majeure from a blunt termination instrument into a flexible mechanism for navigating trade disruptions while maintaining essential supplier partnerships.

### TARIFF-SPECIFIC DISPUTE RESOLUTION FRAMEWORK

Create a structured process for addressing tariff disputes before they escalate. This prevents prolonged disagreements that can damage business relationships and compound financial impacts. Here is a sample of a three-level escalation framework:

1. Operational level (5 days): Contract managers meet to exchange documentation and propose initial solutions. These individuals have the authority to make practical adjustments up to defined thresholds (e.g., 5-10% of contract value).
  2. Department heads (7 days): Mid-level managers with broader authority review and develop equitable solutions. These executives can typically approve more substantial price adjustments (e.g., 10-20% of contract value).
  3. Executive leadership (7 days): Senior executives attempt final resolution before external processes. These decision-makers have the authority to approve significant pricing adjustments (e.g., exceeding 20% of contract value).
- If the internal resolution fails, proceed to mediation before considering more costly and timing-consuming arbitration or litigation.

### CLEAR TERMINATION RIGHTS

While preserving business relationships is ideal, sometimes termination becomes necessary when tariff increases make continued performance commercially unreasonable:

- Define specific tariff-related termination triggers with precise thresholds.
- Document all efforts to negotiate solutions before exercising termination rights.
- Follow contractual notice requirements carefully.
- Include transition provisions that ensure orderly wind-down of affected business.

Termination should be viewed as a last resort. Often, a negotiated solution with an existing supplier, even if it involves some shared financial burden, can provide more advantages than starting from scratch with a new vendor.

### TAKING ACTION

In today's volatile trade environment, proactive contract management is essential for maintaining profitability. By incorporating these targeted provisions into your supply agreements, you can create a more flexible framework that equitably distributes unexpected tariff burdens while protecting your bottom line. The companies that thrive amid uncertainty will be those that combine careful contractual safeguards with open communication. This balanced approach allows both parties to share unexpected burdens while exercising contractual rights only when necessary to protect core business interests.

By implementing these strategies, U.S. buyers can successfully navigate the complexities of international trade and maintain both competitiveness and resilience in the face of rapidly changing tariff landscapes.



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