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Free Trade Agreements

Congress Approves Legislation to Implement US-Mexico-Canada Agreement

On January 16, 2020, the US Senate approved legislation implement the US-Mexico-Canada Agreement (USMCA) by a vote of 89 to 10, sending the legislation to President Trump to be signed into law. The Senate's approval follows a similarly lopsided vote in the House of Representatives, which approved the bill on December 19 by a vote of 385 to 41 (the widest margin in favor of any recent US trade agreement considered in the House). These votes occurred just weeks after the bill's introduction and publication, and despite the signing on December 10 of a "Protocol of Amendment" in which the Parties agreed on multiple, substantive changes to the USMCA text that had not previously been made public. Thus, despite Congress's approval of the USMCA, questions remain about the recent changes to the Agreement and how these and other novel USMCA provisions are reflected in the United States' implementing legislation. This report therefore examines the substance of the recent changes to the USMCA and the measures the United States intends to take in order to implement the Agreement. The report is organized as follows:

- **Section I** describes the key changes that the Parties agreed to in the Protocol of Amendment to the USMCA, signed in Mexico City on December 10;
- **Section II** provides an overview of the US implementing legislation, as well as the accompanying "Statement of Administrative Action" detailing actions the administration will take to implement the USMCA; and
- **Section III** discusses the likely next steps towards the USMCA's entry into force and the implications of the revised Agreement.

I. Key Updates to USMCA under Protocol of Amendment

Addition of "Melted and Poured" Standard for Steel to Automotive Rules of Origin

The USMCA as originally signed by the Parties provided that a passenger vehicle, light truck, or heavy truck could qualify as originating (and thus eligible for preferential tariff treatment) only if the producer could certify that, during the previous calendar year or a comparable timeframe specified in the Agreement, at least 70% of the producer's North American purchases of steel and aluminium qualified as originating (Appendix to Annex 4B, Article 6). The Protocol of Amendment ("Protocol") further tightened this rule by adding a requirement that, beginning seven years after the entry into force of the USMCA, steel may only qualify as originating for purposes of Article 6 if "all steel manufacturing processes…occur in one or more of the Parties, except for metallurgical processes involving the refinement of steel additives." The added language clarifies that "[s]uch processes include the initial melting and mixing and continues through the coating stage", and that "[t]his requirement does not apply to raw materials used in the steel manufacturing process, including steel scrap; iron ore; pig iron; reduced, processed, or pelletized iron ore; or raw alloys." Though these terms and processes are not further defined in the Agreement, the US implementing legislation for the USMCA authorizes the Secretary of the Treasury to issue regulations pertaining to the steel purchase requirement, as well as the aluminum purchase requirement (which is not subject to a "melted and poured" standard).[1] Such regulations may provide additional detail on how steel products may qualify as originating for purposes of Article 6.

Creation of "Rapid-Response" Dispute Settlement Mechanism for Labor Complaints

The Protocol added to the Dispute Settlement Chapter a new Facility-Specific Rapid Response Labor Mechanism ("Mechanism") that will apply between the United States and Mexico (Annex 31-A). The stated goal of the Mechanism is to ensure workers in the two countries are not denied the right of free association and collective bargaining. The Mechanism establishes a two-stage process for addressing allegations that workers at a specific facility are being denied such rights: (1) an initial review period, during which the Parties may attempt to resolve the issue bilaterally; and (2) a formal dispute settlement process, in which an independent panel will determine whether the alleged "Denial of Rights" exists. Where a Panel determines that a Denial of Rights exists, the complaining Party

[1] Rather the Protocol amended the USMCA to provide that "[t]en years after entry into force of this Agreement, the Parties shall consider appropriate requirements that are in the interests of all three Parties for aluminum to be considered as originating under this Article."

will be authorized to impose remedies targeting imports of goods or services from the facility at issue. Annex 31-B establishes an analogous Mechanism between Canada and Mexico. We provide a general summary of the Mechanism below:

- **Scope.** A Party may bring an action under the Mechanism only where it concerns an alleged violation of free association and collective bargaining rights at a "covered facility", defined as a facility in the territory of a Party that (1) produces a good or supplies a service that is traded between the Parties (or competes in the territory of a Party with a good or service of the other Party); and (2) is a facility in a "Priority Sector", *i.e.*, a sector that produces manufactured goods, supplies services, or involves mining. Manufactured goods are defined as including, but not limited to "aerospace products and components, autos and auto parts, cosmetic products, industrial baked goods, steel and aluminum, glass, pottery, plastic, forgings, and cement." While this definition encompasses a wide range of activities, it does appear to exclude some important industries, such as agriculture. Moreover, the scope of the Mechanism is further limited by a requirement that alleged violations pertain to the domestic law of the party at issue. In particular, with respect to the United States, "a claim can be brought only with respect to an alleged Denial of Rights owed to workers at a covered facility under an enforced order of the National Labor Relations Board." Similarly, with respect to Mexico, a claim can be brought only with respect to an alleged Denial of Rights "under legislation that complies with Annex 23-A" of the USMCA, which concerns worker representation in collective bargaining in Mexico.

- **Step 1: Requests for Review and Remediation.** If a complainant Party "has a good faith basis to believe that a Denial of Rights is occurring at a Covered Facility", it must first request that the respondent Party conduct its own review of whether a Denial of Rights exists, and that the respondent Party attempt to remediate any such Denial of Rights within 45 days of the request. The Mechanism provides multiple avenues for the dispute to be resolved at this initial stage, *i.e.*, without the formation of a Panel or the imposition of remedies (for example, if the respondent Party determines that there is no Denial of Rights and this finding is accepted by the complainant, or if the respondent Party determines that there is a Denial of Rights and agrees with the complainant on a course of remediation). Alternatively, the complainant may request the formation of a "Rapid Response Labor Panel" ("Panel") to conduct a separate verification and determination if (1) the respondent Party does not conduct the requested review; (2) the respondent Party finds that there is no Denial of Rights but the complainant disagrees; or (3) the Parties cannot agree on a course of remediation for a Denial of Rights.

  The Mechanism also provides that, in certain circumstances, the complainant Party may impose remedies without first obtaining a determination from a Panel that a Denial of Rights exists. Pursuant to Article 31-A.4.8, if the Parties agree upon a course of remediation but the complainant considers that the Denial of Rights has not been remediated by the agreed-upon date, the complainant may "notify the respondent of its intention to impose remedies at least 15 days prior to imposing remedies." However, the respondent Party may, within 10 days of receiving such a notice, request a determination from a Panel as to whether the Denial of Rights persists, and the complainant Party will be prohibited from imposing remedies until the Panel makes its determination.

- **Step 2: Panel Proceedings and Verification.** Once a Party has submitted a petition to the USMCA Secretariat requesting the establishment of a "rapid response" Panel, the Secretariat must appoint panelists within three days.[2] Upon confirmation that the petition contains the relevant information, the Panel must issue a request for "verification" to the respondent Party (which the respondent Party may accept or refuse). If the respondent Party agrees to the verification, the Panel must conduct the verification within 30 days after the

[2] The Secretariat must select by lot one panelist from the complainant Party's list, one from the respondent Party's list, and one from a Joint List.

receipt of the request by the respondent Party, and observers from both Parties may accompany the Panel in any on-site verification if both Parties so request. Though the Agreement does not elaborate on what "verifications" will entail, this language indicates that they may include visits by the Panel to the covered facility at issue. Alternatively, if the respondent Party refuses the request for a verification or does not respond within seven business days, the complainant Party may request that the Panel make a determination as to whether there is a Denial of Rights, and the Panel "shall take the respondent Party's refusal to allow a verification into account." The Panel must make a determination as to whether there has been a Denial of Rights within 30 days after conducting a verification, or within 30 days after it is constituted if there has not been a verification, and this determination will be made public. The Agreement provides that the Panel "shall provide both Parties an opportunity to be heard" before making its determination, but it does not elaborate on the process by which Parties may provide input to the Panel.

- **Step 3: Imposition of Remedies.** After receipt of a determination by a Panel that there has been a Denial of Rights, the complainant Party may impose remedies after providing written notice to the respondent Party at least 5 business days in advance. The complainant Party is afforded broad discretion to "impose remedies that are the most appropriate to remedy the Denial of Rights." Remedies may include (1) suspension of preferential tariff treatment for goods manufactured at the Covered Facility; or (2) the imposition of "penalties" (which are not defined in the Agreement) on goods manufactured at or services provided by the Covered Facility. The Agreement places no further limitations on the form or severity of any penalties, except that they must be "proportional to the severity of the Denial of Rights and shall take the panel's views on the severity of the Denial of Rights into account[.]" In cases where a Covered Facility (or a Covered Facility owned or controlled by the same person producing the same or related goods) has received a prior Denial of Rights determination on at least two occasions, remedies may also include the denial of entry of goods (*i.e.*, an import ban on goods produced by the Covered Facility).

- **Step 4: Removal of Remedies.** After a Party has imposed remedies, the Parties "shall continue to consult on an ongoing basis in order to ensure the prompt remediation of the Denial of Rights and the removal of remedies." If the Parties reach agreement that the Denial of Rights has been remediated, the remedies must be removed immediately. If the Parties are in disagreement as to whether the Denial of Rights has been remediated, the respondent Party may request an opportunity to demonstrate to the Panel that it has remediated the Denial of Rights, and the Panel must make a new determination within 30 days. However, if the Panel then determines that the Denial of Rights has not been remediated, the respondent will be prohibited from requesting another determination for 180 days, during which time the remedies may remain in place.

- **Recourse to State-to-State Dispute Settlement.** A Party will have recourse to the USMCA's state-to-state dispute settlement procedures under Chapter 31 if it considers that another Party "has not acted in good faith" in its use of the Mechanism, either with regard to (1) an invocation of the Mechanism itself; or (2) an imposition of remedies "that are excessive in light of the severity of the Denial of Rights found by the panel[.]" If a dispute settlement panel agrees that a Party "did not act in good faith" in its use of the Mechanism and the Parties are unable to resolve the issue through consultations, the complainant may elect to "prevent the responding Party from using [the Rapid Response Mechanism] for a period of two years", or to impose another remedy permitted under the dispute settlement chapter.

Though recent US trade agreements have included labor obligations that are subject to state-to-state dispute settlement, the "rapid response" Mechanism envisioned in Annex 31-A is novel in several important respects. Whereas state-to-state dispute settlement aims to determine whether government measures or patterns of behavior violate the Agreement, the Mechanism is aimed at identifying and remedying isolated instances in which labor rights are being denied by a specific private company (regardless of whether a USMCA Party government violated the Agreement). Thus, allegations under the Mechanism might occur more frequently than state-to-state disputes

concerning labor obligations, which are relatively rare, particularly given that the US implementing legislation permits US parties such as labor unions to submit petitions for action under the Mechanism.

Moreover, the Mechanism could result in remedial measures on specific companies that actually exceed the level of benefits that such companies accrue under the trade agreement. WTO and FTA dispute settlement systems traditionally limit the form and dollar value of any countermeasures authorized thereunder: violations suspend trade agreement benefits to match the level of harm experienced by the complaining party and do not permit the targeting of specific facilities. By contrast, the Mechanism gives a complaining Party discretion to suspend preferential tariff treatment and to impose additional, undefined "penalties" targeting offending facilities, provided that such remedies are "proportional" to the violation at issue. This could result in the goods of offending facilities being treated worse than the goods of a party not subject to the USMCA or another US trade agreement. Thus, while the Agreement states that the goal of the Mechanism is "to ensure remediation of a Denial of Rights…not to restrict trade", it might nonetheless prompt a wave of new allegations and company-specific trade restrictions targeting Mexican facilities, particularly in the "priority sectors" specified in the Agreement.

Other Changes to Labor and Environment Chapters

The Protocol makes several additional changes aimed at making the USMCA's labor and environmental rules more easily enforceable through state-to-state dispute settlement, and expanding the scope of the environmental obligations:

- **Presumption that violations affect trade and investment.** The USMCA originally provided that, to establish a violation of an obligation pertaining to Labor Rights under Article 23.3, a complaining Party must demonstrate that the respondent failed to adopt or maintain the required statutes, regulations, or practices "in a manner affecting trade or investment between the Parties." A similar qualification applied to several other obligations in the Labor and Environment Chapters, including those set forth in Article 23.4 (Non-Derogation), Article 23.5 (Enforcement of Labor Laws), Article 23.6 (Forced or Compulsory Labor), Article 23.7 (Violence Against Workers), Article 24.4 (Enforcement of Environmental Laws), Article 24.8 (Multilateral Environmental Agreements), and Article 24.22 (Conservation and Trade), among others. The Protocol amended these provisions to establish that, "[f]or purposes of dispute settlement, a panel shall presume that a failure is in a manner affecting trade or investment between the Parties, unless the responding Party demonstrates otherwise". By shifting the burden of proof to the responding Party, this change may make it easier for a complaining Party to establish that a violation of the USMCA's labor or environmental commitments has occurred.
- The Protocol revised Article 23.6.1 (Forced or Compulsory Labor) to establish that a Party "shall prohibit the importation of goods into its territory" that are produced by forced or compulsory labor, removing the caveat that a Party may do so "through measures it considers appropriate".
- The Protocol revised Article 23.7 (Violence Against Workers) to provide that "no Party shall fail to address violence or threats of violence against workers, directly related to exercising or attempting to exercise the rights set out in Article 23.3 (Labor Rights)" (whereas the USMCA originally prohibited such failures only where they occurred "through a sustained or recurring course of action or inaction").
- The Protocol added in Article 24.8 (Multilateral Environmental Agreements) a requirement that each Party "adopt, maintain, and implement laws, regulations, and all other measures" necessary to fulfill its obligations under the following multilateral environmental agreements:
  - The Convention on International Trade in Endangered Species of Wild Fauna and Flora ("CITES"), done at Washington, March 3, 1973, as amended;

- The Montreal Protocol on Substances that Deplete the Ozone Layer, done at Montreal, September 16, 1987, as adjusted and amended;
- The Protocol of 1978 Relating to the International Convention for the Prevention of Pollution from Ships, 1973, done at London, February 17, 1978, as amended;
- The Convention on Wetlands of International Importance Especially as Waterfowl Habitat, done at Ramsar, February 2, 1971, as amended;
- The Convention on the Conservation of Antarctic Marine Living Resources, done at Canberra, May 20, 1980;
- The International Convention for the Regulation of Whaling, done at Washington, December 2, 1946; and
- The Convention for the Establishment of an Inter-American Tropical Tuna Commission, done at Washington, May 31, 1949.

This change expands the scope of the USMCA Environment Chapter, which previously contained such an obligation only with respect to the CITES.

Intellectual Property

The Protocol makes the following notable changes to the USMCA's Intellectual Property Chapter:

- **Removal of biologics provision.** The Protocol removed Article 20.49 (Biologics), which would have required the Parties to provide market exclusivity protection for biologic medicines for a period of 10 years. This change represents a significant departure from recent US trade policy, and from the Trump administration's own stated negotiating objective to "[s]eek provisions governing intellectual property rights that reflect a standard of protection similar to that found in U.S. law."
- **Removal of 3-Year exclusivity period.** The revised USMCA retains the requirement set forth in Article 20.48 that, where a Party requires the submission of undisclosed test or other data as a condition for granting marketing approval for a new pharmaceutical product, it may not permit third persons to market the same or a similar product on the basis of that information (or the original marketing approval) for at least five years. However, the Protocol removed a requirement that the Parties also provide such exclusivity for a period of at least three years "with respect to new clinical information submitted as required in support of a marketing approval of a previously approved pharmaceutical product covering a new indication, new formulation, or new method of administration." Congressional Democrats have stated that they sought the removal of this requirement because it allegedly would enable pharmaceutical manufacturers to "delay competition and access to affordable medicines."
- **Removal of obligation to make certain patents available.** The Protocol removed the requirement set forth in Article 20.36.2 that each Party make patents available for new uses of a known product, new methods of using a known product, or new processes of using a known product. According to Congressional Democrats, this provision allegedly "would have locked in the practice of 'patent evergreening,' in which pharmaceutical companies obtain hundreds of patents related to a product to block generic competition and price reductions."
- **Limits on patent term extensions.** Article 20.46 originally required each Party to make patent adjustments available to compensate a patent owner for unreasonable curtailment of the effective patent term as a result of the marketing approval process, though it recognized that such adjustments could be subject to "conditions and limitations" that were not specified in the Agreement. The Protocol amended this provision to expressly permit the following "conditions and limitations" on patent term adjustments:

- Limiting the applicability of the provision to a single patent term adjustment for each pharmaceutical product that has been granted marketing approval;
- Requiring the adjustment to be based on the first marketing approval granted to the pharmaceutical product in that Party;
- Limiting the period of the adjustment to a maximum of 5 years; and
- If a Party makes available a period of additional *sui generis* protection, limiting the period of the additional *sui generis* protection to a maximum of 2 years.

Dispute Settlement

The Protocol made several revisions to the Dispute Settlement Chapter that aim to prevent a Party from blocking the composition of panels or the establishment of the roster from which panelists must be selected. These changes, which are summarized below, respond to concerns expressed by congressional Democrats and other stakeholders that "panel blocking" remained possible under the original USMCA.

- **Establishment of roster (Article 31.8).** First, with respect to the establishment of the roster from which panelists will be selected, the Protocol maintains the requirements that "[e]ach Party shall designate up to 10 individuals" and that "[t]he Parties shall endeavor to achieve consensus on the appointments". However, the Protocol added that "[i]f the Parties are unable to achieve consensus by one month after the date of entry into force of this Agreement, the roster shall be comprised of the designated individuals." Thus, if one or two USMCA Parties were to refuse to designate individuals to the roster, the roster would consist of the inviduals designated by the remaining Party or Parties.
- **Panel composition (Article 31.9).** The Protocol maintains the requirement that, if the Parties are unable to agree on the chair of a Panel within 15 days, the disputing Party chosen by lot "shall select within five days as chair an individual who is not a citizen of that Party." However, the Protocol added that if the responding Party "refuses to participate or fails to appear for the choosing by lot procedure", the complaining Party will be permitted to select a chair from the roster who is not a citizen of that Party. The same rule will apply if the responding Party refuses to select the two additional panelists it is required to select in order to complete the composition of a five-member panel.

These changes appear likely to prevent a responding Party from engaging in most forms of "panel blocking". However, the revised Agreement does not clarify how Panels will be composed in the event that one or more Parties have failed to designate individuals to the roster under Article 31.8. The revised Agreement at Article 31.8.1 states that "[i]f a Party fails to designate its individuals to the roster, the Parties may still request the establishment of panels under Article 31.6 (Establishment of a Panel)", but it does not specify how a panel will be composed in such circumstances. Rather, it states only that "[t]he Rules of Procedure, which shall be established by the date of entry into force of this Agreement, shall provide for how to compose a panel in such circumstances." By leaving this process to be clarified in the Rules of Procedure, the revised USMCA leaves some ambiguity, at least for the time being, as to how panels will be composed in these circumstances.

In addition, the Protocol added a requirement that the Rules of Procedure for dispute settlement panels "include rules of evidence". These rules must ensure that:

- The disputing Parties have the right to submit testimony in person or via declaration, affidavit, report, teleconference, or videoconference, and the disputing Parties and the panel the right to test the veracity of such testimony;

- The disputing Parties have the right to submit anonymous testimony and redacted evidence, in appropriate circumstances;
- The panel may request, on its own initiative or at the request of a disputing Party, that a Party make available documents or other information relevant to the dispute, and may take a failure to comply with such request into account in its decision; and
- A panel shall accept the disputing Parties' stipulations in advance of the hearing.

Congressional Democrats advocated the inclusion of such rules of evidence in the USMCA's dispute settlement procedures, on the grounds that they "will help the United States successfully litigate labor, environmental, and other fact-intensive disputes."

II. US Implementing Legislation

On December 13, 2019, the Trump administration submitted the following materials to Congress pursuant to Section 106(a)(1)(E) of the *Bipartisan Congressional Trade Priorities and Accountability Act of 2015* ("TPA 2015"):[3]

- A draft USMCA implementing bill, titled the *US-Mexico Canada Agreement Implementation Act* and later introduced by Reps. Steny Hoyer (D-MD) and Kevin McCarthy (R-CA) as HR 5430;[4]
- The final legal text of the USMCA as amended by the Protocol of Amendment;[5] and
- A statement of the administrative actions proposed to implement the Agreement ("Statement of Administrative Action" or "SAA").[6]

As required by TPA 2015, the implementing bill contains provisions approving the USMCA itself and the accompanying Statement of Administrative Action. In addition, TPA 2015 requires that, "if changes in existing laws or new statutory authority are required" to implement an agreement, the implementing bill must contain "such provisions as are strictly necessary or appropriate" to do so (19 U.S.C. § 4202(b)(3)). Accordingly, the implementing bill contains multiple provisions that either repeal or amend existing laws or provide new statutory authority that the Trump administration considers "strictly necessary or appropriate" in order to implement the USMCA. The bill and the SAA therefore provide some initial guidance as to how the Trump administration intends to implement novel provisions of the USMCA, such as the revised rules of origin for automotive goods, labor enforcement mechanisms, and the sunset clause. We provide an overview of the key provisions of the implementing bill and the SAA below.

Congressional Approval of USMCA

Section 101(a) of the implementing bill contains Congress's express approval of (1) the USMCA; (2) the *Protocol Replacing the North American Free Trade Agreement with the Agreement between the United States of America, the United Mexican States, and Canada* ("Protocol"), of which the USMCA is a part; and (3) the SAA submitted by the Trump administration. The Protocol, which the parties signed alongside the USMCA in November 2018, provides that the USMCA (which constitutes an Annex to the Protocol) "shall supersede the NAFTA" upon the Protocol's entry into force. Pursuant to Article 2 of the Protocol, the Protocol and the USMCA cannot enter into force until each Party has notified the other Parties, in writing, that it has completed the internal procedures required for the entry into force

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[3] 19 U.S.C. § 4205(a)(1)(E)

[4] The text of the legislation is available at **https://www.congress.gov/116/bills/hr5430/BILLS-116hr5430rs.pdf.**

[5] The final legal text of the USMCA is available at **https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada- agreement/agreement-between.**

[6] The SAA is available at **https://www.finance.senate.gov/imo/media/doc/FINAL%20SAA%20USMCA.pdf.**

of the Protocol. The Protocol, including the USMCA, will enter into force "on the first day of the third month following the last notification." For example, if the last notification is provided on March 15, 2020, the USMCA will enter into force on June 1, 2020.

Authority to Provide US Notification Triggering Entry Into Force; Repeal of NAFTA Implementation Act

Section 101(b) of the implementing bill authorizes the President to provide written notification to Canada and Mexico that the United States has completed its domestic legal procedures (as is required for the USMCA to enter into force), but only after the President has:

- Determined that Canada and Mexico have taken the measures necessary to comply with those provisions of the USMCA that are to take effect at the time the Agreement enters into force; and
- Provided written notice of this determination to Congress in accordance with Section 106(a)(1)(G) of TPA 2015.[7] Specifically, the President may provide for the USMCA to enter into force "not earlier than 30 days after the date on which" the aforementioned notification is submitted to Congress.

Thus, the timing of the United States' notification will be subject to the discretion of the Executive Branch, and will depend in part on how quickly Canada and Mexico are able to develop and enact any measures that, in the view of the United States, are necessary to bring them into compliance with their initial obligations under the Agreement.

In addition, Section 601 of the implementing bill provides that, upon the USMCA's entry into force, the NAFTA Implementation Act (which implemented the NAFTA under US law) will be repealed. The US-Canada Free Trade Agreement, which the parties suspended upon the entry into force of the NAFTA, will remain suspended while the USMCA is in force.

Implementing Actions, Initial Regulations, and Tariff Proclamation Authority

Section 103 of the implementing bill authorizes the Executive Branch to take certain actions necessary to implement the USMCA, including during the period between the enactment of the legislation and the USMCA's entry into force. The actions authorized are as follows:

- **Implementing actions**. The Executive Branch is authorized to issue new or amended regulations and to proclaim actions "as may be necessary" to ensure that provisions of the implementing bill that take effect on the date the USMCA enters into force are "appropriately implemented" on such date.
- **Initial regulations; Uniform Regulations.** The bill requires that, "to the maximum extent feasible", all federal regulations required or authorized therein (or proposed in the SAA) in order to implement immediately-applicable US obligations under the USMCA are to be prescribed within one year after the Agreement's entry into force, with certain exceptions. For example, the bill requires that the "Uniform Regulations" envisioned in the USMCA be prescribed "not later than the date on which the USMCA enters into force", consistent with the Parties' obligations under Article 5.16 of the Agreement. Article 5.16 provides that the Parties "shall, by entry into force of [the USMCA], adopt or maintain through their respective laws or regulations, Uniform Regulations regarding the interpretation, application, and administration of [Chapter 5 (Origin Procedures)], Chapter 4 (Rules of Origin), Chapter 6 (Textile and Apparel Goods), Chapter 7 (Customs Administration and Trade Facilitation) and other matters as may be decided by the Parties."
- Proclamation authority for tariff modifications and rules of origin. The President is authorized to implement by Proclamation the tariff modifications provided for in the USMCA, and to proclaim, as part of the HTS, the

[7] 19 U.S.C. § 4205(a)(1)(G))

product-specific rules of origin set forth in Annex 4-B of the USMCA, including those applicable to automotive goods (see below).

Customs and Rules of Origin

Title II of the bill codifies into law the four general rules of origin set forth in the USMCA[8] and provides various customs-related authorities and directives pertaining to claims for preferential tariff treatment under the Agreement. For example, Section 207 of the bill authorizes the Secretary of the Treasury to conduct verifications to determine whether a good qualifies as originating, and sets forth the procedures for conducting such verifications. Other provisions of Title II establish requirements governing claims for preferential tariff treatment, certifications of origin, and recordkeeping requirements for importers. The bill directs the Secretary of the Treasury to prescribe any regulations necessary to implement these requirements.

In addition, Title II authorizes the Executive Branch to take a range of actions to implement the new automotive rules of origin set forth in the Appendix to Annex 4-B ("Automotive Appendix") of the USMCA. Among other changes, these revised rules will (1) increase the regional value content (RVC) requirements applicable to automotive goods; (2) establish a new "labor value content" requirement that goods must satisfy to be considered originating; and (3) require vehicle producers to source a specified percentage of their steel and aluminum purchases from North American sources in order for vehicles to qualify as originating. In order to implement these requirements, the legislation provides the following authorities:

- **Labor value content (LVC) and verifications (Departments of Labor and Treasury).** Section 202A(c)(1) codifies the requirement that a vehicle will be eligible for preferential tariff treatment only if the producer of the vehicle provides a certification to the Commissioner of US Customs and Border Protection (CBP) that its production meets the labor value content requirements set forth in the USMCA. The same section authorizes the Secretary of the Treasury, in consultation with the Secretary of Labor, to prescribe regulations implementing this requirement, "including regulations setting forth the procedures and requirements for a producer of covered vehicles to establish that the producer meets the labor value content requirements[.]" Separately, Section 210 of the bill authorizes the Secretary of Labor to prescribe regulations necessary to carry out the required determinations regarding a vehicle's labor value content.

  In addition, Section 202A(e) establishes a process by which the Secretary of the Treasury, in conjunction with the Secretary of Labor, may conduct a "verification" of whether a vehicle complies with the LVC requirements in the context of a general verification of origin under Section 207. The role of each agency in such verifications will be as follows:

  - The Secretary of Labor will verify whether the production of the vehicle meets the high-wage component of the LVC requirements, including the wage component of the high-wage material and manufacturing expenditures, the high-wage technology expenditures, and the high-wage assembly expenditures.

[8] Under the USMCA, a good generally will qualify as originating, and will therefore be eligible for preferential tariff treatment, if it satisfies one of the following criteria:

- The good is wholly obtained or produced entirely in the territory of one or more Parties.
- The good is produced entirely in the territory of one or more of the Parties using non-originating materials, provided the good satisfies the applicable product-specific rules of origin set forth in the Agreement.
- The good is produced entirely in the territory of one or more of the Parties exclusively from originating materials.
- The good is produced entirely in the territory of one or more of the Parties, is classified with its materials or satisfies the "unassembled goods" requirement, and meets an RVC threshold specified in the Agreement.

- The Secretary of the Treasury will verify all other components of the LVC requirements, including the annual purchase value and cost components of the high-wage material and manufacturing expenditures.

  The legislation provides that, as part of the verification process, the above agencies may request records and information from vehicle producers, including with respect to wages, hours, and job responsibilities.

- **Steel and aluminum (Treasury).** Section 202A(c)(2) codifies the requirement that a vehicle will be eligible for preferential tariff treatment only if the producer of the vehicle provides a certification to CBP that its production meets the steel and aluminum purchase requirements set forth in the USMCA. The same section authorizes the Secretary of the Treasury to prescribe regulations implementing this requirement, "including regulations setting forth the procedures and requirements for a producer of covered vehicles to establish that the producer meets the steel and aluminum purchase requirements[.]"

- **Alternative staging regime (USTR).** Section 202A(d) directs USTR to establish the procedures and requirements to implement the alternative staging regime provided for in Article 8 of the Automotive Appendix to the USMCA. Pursuant to Article 8, up to 10% (and in some instances more than 10%) of a producer's North American vehicle or light truck production may qualify as originating under less-stringent RVC and LVC requirements during a temporary transitional period following the USMCA's entry into force (*i.e.*, until January 1, 2025 or five years after entry into force of the USMCA, whichever is later). Article 8.5 provides that a Party may apply this alternative staging regime "on a producer-by-producer basis", and the implementing legislation sets forth the process by which USTR will accept requests for, and determine whether to authorize, the use of the regime by individual producers. This process will include the following:

  - **Publication of requirements.** Within 90 days after the bill's enactment, USTR must publish in the Federal Register the requirements, procedures, and guidance necessary to implement the alternative staging regime. This notice will include the procedures, calculation methodology, timeframe, specific regional value content thresholds, and other minimum requirements with which producers subject to the alternative staging regime must comply. In addition, this notice will set a deadline by which requests for the alternative staging regime must be submitted, and detail the information that vehicle producers must include in such requests "to demonstrate the actions that the producer will take to be prepared to meet all the requirements set forth in [the automotive rules of origin] after the alternative staging regime period has expired[.]" Finally, the notice will include the criteria that USTR will consider when determining whether to approve a request for the alternative staging regime.

  - **Review and approval of requests.** The legislation requires USTR to determine whether to grant requests for the use of the alternative staging regime within 120 days of receiving such requests. USTR must make its determinations in accordance with the following criteria, and make available a public list of producers that have been authorized to use the alternative staging regime:

    - USTR must authorize the use of the alternative staging regime if it determines that (1) the request covers passenger vehicles or light trucks that do not exceed 10 percent of the total production in USMCA countries of the requesting producer; and (2) the producer "has identified with specificity which of the requirements set forth in [the automotive rules of origin] the producer is unable to meet based on current business plans." If USTR determines that the request covers more than 10 percent of the producer's total production in USMCA countries, USTR "shall authorize" the use of the alternative staging regime if it determines that the producer "has identified with specificity which of the requirements set forth in [the automotive rules of origin] the producer is unable to meet based on current business plans"; and (2) the producer's request included a "detailed and credible plan...based on substantial evidence and reasonably calculated to bring the production of the passenger vehicles or

light trucks, as the case may be, into compliance with the requirements set forth in [the automotive rules of origin] after the alternative staging regime period has expired."

  - **Revocation of alternative staging regime.** The legislation provides that USTR must revoke an authorization for use of the alternative staging regime if, at any time, it determines that the producer (1) failed to take the steps set forth in its request and therefore will no longer be able to meet the requirements of the USMCA's automotive rules of origin after the alternative staging regime has expired; or (2) provided false or misleading information in its request. In addition, in the case of a producer authorized to use the alternative staging regime for more than 10 percent of its production, USTR must revoke such authorization if the producer fails to notify USTR of material changes to circumstances that will prevent the producer from meeting the automotive rules of origin after the alternative staging regime has expired. If a producer's authorization is revoked, any claim for preferential tariff treatment under the alternative staging regime for any covered vehicle of that producer will be considered invalid. In this scenario, the importer of any such vehicle will be liable for the duties that would have been applicable if preferential tariff treatment had not applied on the date when the vehicle was entered for consumption, plus interest, "notwithstanding the finality of a liquidation of an entry[.]"

- **Interagency committee.** Section 202A(b) directs the President to establish, within 30 days of the bill's enactment, an interagency committee to provide advice "on the implementation, enforcement, and modification of provisions of the USMCA that relate to automotive goods, including the alternative staging regime", and to "review the operation of the USMCA with respect to trade in automotive goods[.]" The interagency committee will be led by USTR and will include representatives from CBP, the International Trade Commission, the Department of Commerce, and the Department of Labor. According to the SAA, the committee will "issue guidelines to facilitate implementation and enforcement of provisions of the USMCA related to automotive goods."

Labor

The implementing bill requires the establishment of several new administrative bodies to oversee the implementation and enforcement of the USMCA's labor commitments, particularly with respect to Mexico, and to recommend dispute settlement actions to USTR. In addition, the bill authorizes the Executive Branch to restrict imports of goods and services from Mexican facilities that are the subject of adverse findings under the Agreement's "rapid response" mechanism for labor disputes (described in Section I above). These new entities and authorities are summarized below.

Interagency Labor Committee and Petition Process

Within 90 days after the enactment of the legislation, the President must establish an Interagency Labor Committee for Monitoring and Enforcement ("Labor Committee") that will "monitor the implementation and maintenance" of the USMCA's labor obligations and Mexico's labor reform. Importantly, the Labor Committee also will be empowered to receive petitions and make recommendations to USTR for dispute settlement actions under the Agreement, as explained below. The Labor Committee will be co-chaired by the US Trade Representative and the Secretary of Labor, and may include representatives of other Federal departments or agencies of the President's choosing.

- **Petition process.** Pursuant to Section 716 of the bill, the Labor Committee will establish procedures for accepting two types of petitions from the public concerning alleged violations of the USMCA's labor obligations: "facility-specific petitions" relating to denial of free association and collective bargaining rights at a covered facility, as defined in Annex 31-A of the USMCA (the "Rapid Response Labor Mechanism"); and (2) petitions relating to any other violation of the USMCA's labor obligations. Within 30 days after receiving a facility-specific

petition, the Labor Committee must determine whether there is sufficient, credible evidence of a Denial of Rights to enable the "good-faith invocation" of the Mechanism. If this determination is affirmative, USTR (1) "shall submit" a request for an initial review of that facility under the Mechanism; and (2) shall determine, within 60 days after the Labor Committee's affirmative determination, whether to request the establishment of a rapid response panel under the Mechanism. In the case of a petition involving any other alleged violation of the USMCA's labor obligations, the Labor Committee shall determine within 20 days whether the allegation warrants further review, and shall determine within 60 days thereafter whether there is credible evidence of a violation. If the latter determination is affirmative, USTR must initiate enforcement actions under the USMCA's Labor or Dispute Settlement Chapters within 60 days, or notify Congress of its reasons for declining to initiate such action.

- **Recommendations.** In addition to making the above determinations based on petitions from the public, the Labor Committee may independently recommend dispute settlement actions to USTR based on its own monitoring activities and assessments. Where the Labor Committee determines that a USMCA country has failed to meet its labor obligations, including Mexico's labor reform commitments under Annex 23–A, the Committee "shall recommend" that USTR initiate (1) consultations under the USMCA Labor Chapter; (2) state-to- state dispute settlement proceedings; or (3) proceedings under the Rapid Response Labor Mechanism. USTR must determine within 60 days of receiving such a recommendation whether it will initiate such proceedings.

Authority to Restrict Imports Pursuant to Rapid Response Labor Mechanism

Title VII of the bill authorizes the Executive Branch to impose potentially severe penalties on imported goods from Mexico that are the subject of an adverse panel finding under the Rapid Response Labor Mechanism. The procedures for imposing such remedies are as follows:

- **Suspension of liquidation.** Section 752 provides that, if the United States requests a review of an alleged Denial of Rights under the Mechanism, USTR "may" direct the Treasury Secretary to suspend liquidation for unliquidated entries of goods from the facility that is the subject of the allegation until (1) a rapid response labor panel determines that there is no Denial of Rights; (2) a course of remediation for a Denial of Rights has been agreed to and completed within the agreed-upon timeframe; or (3) the Denial of Rights has been otherwise remedied.
- **Final remedies.** Section 753 provides that, if a rapid response labor panel determines that there has been a Denial of Rights, USTR may direct the Treasury Secretary to (1) deny entry to goods "produced wholly or in part" from any covered facility involved in the case; or (2) allow for the release of such goods only upon payment of duties "and any penalty"; and (3) apply any duties or penalties to customs entries for which liquidation was suspended; and (4) apply any other remedies that are "appropriate and available" under the rapid response labor mechanism. These measures may be imposed until the Denial of Rights has been remedied. As noted above, neither the legislation nor the USMCA itself defines or places specific limits on the types of "penalties" that may be imposed, except that (1) Article 31-A.10.1 requires that the remedy chosen be "proportional to the severity of the Denial of Rights"; and (2) Article 31-A.10.4 permits a Party to deny entry to goods only in cases where a covered facility or the owner of a covered facility "has received a prior Denial of Rights determination on at least two occasions[.]"

Other Labor Entities

The implementing bill also directs the Executive Branch to appoint "Mexico Labor Attachés", an "Independent Mexico Labor Expert Board", and a "Forced Labor Enforcement Task Force", which will carry out the following functions:

- **Mexico Labor Attachés.** The Secretary of Labor must appoint "up to 5" full-time officers who will be located in Mexico and will assist the Interagency Labor Committee with monitoring and enforcement of Mexico's compliance with its labor obligations.
- **Independent Mexico Labor Expert Board.** The legislation establishes an Independent Mexico Labor Expert Board that will produce an annual report assessing Mexico's efforts to implement its labor reform legislation from 2019. Based on the report, the Interagency Labor Committee may recommend dispute settlement actions to USTR. The Board will have 12 members, four appointed by the Labor Advisory Committee for Trade Negotiations and Trade Policy, and eight appointed by the Congress.
- **Forced Labor Enforcement Task Force.** Within 90 days after the bill's enactment, the President must establish a task force to monitor the enforcement of the United States' prohibition on the importation of goods made with forced labor, set forth in section 307 of the Tariff Act of 1930 (19 U.S.C. § 1307). In addition, the task force within 90 days of its establishment must establish timelines for responding to petitions alleging that goods being imported are made with child labor or forced labor. The task force also will have specific duties related to Mexico, including (1) the development of an "enforcement plan" regarding goods produced with forced labor in Mexico; and (2) reporting to the Interagency Labor Committee on concerns and allegations regarding forced labor in Mexico. The task force will be chaired by the Secretary of Homeland Security, and will include representatives from USTR, the Department of Labor, and other agencies of the President's choosing.

Other USMCA Chapters

Many of the USMCA's chapters are not discussed extensively in the implementing legislation, including those covering Sanitary and Phytosanitary Measures, Technical Barriers to Trade, Investment, Trade in Services, Financial Services, Digital Trade, Telecommunications, Intellectual Property Rights, and State-Owned Enterprises. The SAA notes that, in the view of the administration, no statutory changes are required to implement these Chapters because US laws and regulations already are in conformity with the obligations the United States has assumed thereunder.

The implementing bill therefore is largely silent with respect to these Chapters.

Sunset Provision

Article 34.7 of the USMCA, known as the "sunset" clause, provides that the Agreement "shall terminate 16 years after the date of its entry into force" unless each Party confirms that it "wishes to continue this Agreement for a new 16-year term" in accordance with the procedures set forth in the Agreement. Those procedures state that, on the sixth anniversary of the entry into force of the Agreement, the Parties will meet to conduct a "joint review" of the operation of the Agreement, review "any recommendations for action submitted by a Party", and "decide on any appropriate actions." As part of the review, each Party "shall confirm, in writing, through its head of government, if it wishes to extend the term of [the USMCA] for another 16-year period." Assuming the Agreement enters into force in 2020, this review would take place in 2026, and the Parties would decide in the review whether to extend the Agreement for another 16-year term (*i.e.*, through 2052.) The Agreement provides for such reviews to continue in perpetuity at regular intervals, with the possibility that the Agreement will terminate if any one Party withholds consent for its extension.

The implementing bill does not indicate whether Congress must vote on whether the United States consents to extending the USMCA for purposes of joint reviews conducted under Article 34.7. Section 611 of the bill requires the President to "consult with the appropriate congressional committees and stakeholders before each joint review, including consultation with respect to…the decision whether or not to confirm that the United States wishes to extend the USMCA." Such consultations, which are to be led by USTR, must include a public hearing process and the submission of a report to Congress prior to any joint review.

Termination of USMCA

Section 621 of the implementing legislation, which covers "Termination of USMCA", provides that: (1) "[d]uring any period in which a country ceases to be a USMCA country, this Act…and the amendments made by this Act shall cease to have effect with respect to that country"; and (2) "[o]n the date on which the USMCA ceases to be in force with respect to the United States, this Act and the amendments made by this Act…shall cease to have effect." Like the NAFTA Implementation Act, which contains similar language, the USMCA implementing bill does not grant the President the authority to terminate US participation in the Agreement without the consent of Congress.

III. Outlook

With congressional approval of the USMCA now secured, the Agreement should enter into force and replace the NAFTA, but the exact timing remains uncertain. The Canadian Parliament has yet to ratify the Agreement, and although it is expected to do so early this year, the precise timing is not yet clear. Beyond that action, two other requirements discussed in this report will dictate the Agreement's implementation schedule: (1) the implementing bill grants some discretion to the President as to when the United States will formally declare that its ratification process is complete, and this will depend in part on the actions of the other USMCA Parties; and (2) the United States and the other USMCA Parties will need to develop and implement certain measures before the Agreement can enter into force, including the Uniform Regulations that will govern the day-to-day operation of the Agreement. For similar reasons, most US trade agreements have not taken effect for several months (and in some cases more than a year) after the enactment of the relevant implementing legislation. Thus, while it appears likely that the USMCA will enter into force in 2020, this might not occur until the second half of the year.

The expected entry into force of the USMCA will bring a range of new challenges for businesses engaged in North American and global supply chains. While the Agreement is in many respects a continuation of the NAFTA, it contains several novel provisions that have generated uncertainty for business and have the potential to disrupt trade. In particular, the revised automotive rules of origin – which will require producers to provide detailed information on, *inter alia*, wage rates associated with vehicle production, sourcing of steel and aluminum products, and regional value content – will entail a substantial shift from current requirements and compliance practices.

Similarly, the new "rapid response" labor mechanism raises the possibility that companies will be targeted with trade restrictions based on isolated labor disputes, rather than longstanding patterns of labor violations or government actions that violate trade commitments. Moreover, and as described in this report, the US implementing legislation grants the Executive Branch broad authority to implement these and other USMCA requirements, including through regulation. Thus, substantial uncertainty remains as to how key elements of the Agreement will operate in practice. We will continue to provide updates as US government agencies issue regulations and guidance relating to implementation of the USMCA over the coming months.

Finally, the unusual process that led to the USMCA's approval by Congress may presage important shifts in US trade policy. Historically, the TPA timelines and rules prohibiting the amendment of a trade agreement's implementing legislation have been viewed by US negotiating partners as an assurance that any agreement that they sign will receive a relatively quick "up-or-down" vote in Congress. In the case of the USMCA, however, this principle effectively was abandoned, as House Democrats demanded substantive changes to the signed Agreement with the implied threat that, absent such changes, the House would vote to remove the TPA rules guaranteeing a House vote on the Agreement's implementing legislation. Though the move enabled the United States to extract additional concessions from Mexico, this erosion of TPA's procedural guarantees may make other governments more wary of negotiating trade agreements with the United States in the future. Moreover, Congress historically has insisted (and required in TPA) that trade agreements negotiated by the Executive Branch and their implementing legislation be subject to robust transparency, notification, and consultation requirements, thereby ensuring that Congress and the public have adequate opportunity to review and debate them before any congressional vote. In the case of the

USMCA, however, several Members of Congress from both parties complained of a lack of meaningful consultations during the negotiations, and the House voted to approve the implementing bill just days after it and numerous substantive changes to the original USMCA text were made public – even eschewing the normal practice of “mock markups” that allow Members to propose changes to the legislation. In addition, few Members of Congress outside of the House Democratic Working Group on the USMCA were privy to the details of the changes to the USMCA text before they were signed and released to the public. Nevertheless, both Houses of Congress (including some Members who have long advocated greater transparency in trade negotiations) voted swiftly to approve the Agreement. The result may be that the current administration and its successors feel less obligated to adhere to the letter or spirit of TPA’s notification, consultation, and transparency requirements in future negotiations.

US Trade Actions

United States and China Sign “Phase One” Trade Agreement; USTR Implements Tariff Reduction for “List 4A” Goods

On January 15, 2020, President Trump and Chinese Vice Premier Liu He signed “Phase One” of an Economic and Trade Agreement between the United States and China. The Phase One Agreement, which the two sides announced in December, includes commitments by China to increase purchases of goods and services from the United States and to adhere to disciplines covering a range of issues, including agriculture, currency, financial services, and some “structural” issues such as intellectual property rights protection and technology transfer. In addition, the Office of the US Trade Representative (USTR) issued a Federal Register notice today reducing the Section 301 tariff rate on “List 4A” Chinese goods to 7.5% beginning on February 14, consistent with the agency’s December statement announcing the Phase One Agreement. The Phase One Agreement will leave the remaining Section 301 tariffs and Chinese retaliatory tariffs in place, but its signing is nonetheless an important development

that appears likely to avert the near-term escalation of tariffs or other trade and investment restrictions. We provide here a brief overview of the Agreement and its implications.

Section 301 Tariffs and Chinese Retaliation

The Agreement makes no mention of the United States' Section 301 tariffs on products of China, or the retaliatory tariffs that China has imposed on imports from the United States. However, the Trump administration announced in December that, as a result of the Phase One agreement, the United States would: (1) cancel the imposition of a 15% additional duty on "List 4B" goods ($160 billion) that had been scheduled to take effect on December 15, 2019; and (2) reduce to 7.5% (from the current rate of 15%) the additional duty it has imposed on "List 4A" goods ($120 billion) since September 1, 2019. Though these commitments are not reflected in the Agreement, USTR already has suspended the imposition of the List 4B tariffs, and today USTR published a Federal Register **notice** reducing the List 4A tariff to 7.5% with respect to goods entered for consumption, or withdrawn from warehouse for consumption, on or after 12:01 am Eastern Standard Time on February 14, 2020. China suggested in December that it would implement a commensurate reduction of its retaliatory tariffs, but the Agreement is silent on whether (or when) this will occur.

Intellectual Property

The Intellectual Property Chapter includes disciplines related to trade secret protection, pharmaceuticals, patents, piracy, counterfeiting, geographical indications, trademarks, and enforcement measures. The commitments that China has undertaken under the Chapter – particularly those requiring it to provide for the protection of trade secrets through criminal enforcement and other means – appear extensive, are generally binding (rather than aspirational commitments), and in some cases resemble provisions of other US trade agreements such as the USMCA. Nevertheless, the Agreement does not expressly detail required changes to specific Chinese laws and regulations, which the United States reportedly demanded during prior stages of the negotiation. Rather, pursuant to Article 1.35 of the Agreement, the extent to which China intends to modify existing measures in order to implement the IP commitments will be set forth in an "Action Plan" to be published at a later date. This provision states that, within 30 working days after the Agreement enters into force, China will promulgate an Action Plan that specifies "measures that China will take to implement its obligations under [the Intellectual Property Chapter] and the date by which each measure will go into effect." Thus, the extent to which the Agreement will prompt changes to China's existing laws and regulations (and the effect of any such changes) remains to be seen.

Technology Transfer

The Technology Transfer Chapter includes commitments aimed at addressing three alleged Chinese government practices targeted by USTR in its Section 301 investigation: (1) the use of foreign ownership restrictions (*e.g.*, joint venture requirements) to require or pressure technology transfer from US companies; (2) the use of regulations to force US companies to license technology to Chinese entities on non-market based terms; and (3) the facilitation of foreign investment in US companies to obtain technologies and intellectual property. The Chapter aims to curtail such practices through the following general obligations:

- Persons of a Party "shall have effective access to and be able to operate openly and freely in the jurisdiction of the other Party without any force or pressure from the other Party to transfer their technology to persons of the other Party."
- Any transfer or licensing of technology between persons of a Party and those of the other Party "must be based on market terms that are voluntary and reflect mutual agreement."

- A Party is prohibited from supporting or directing "the outbound foreign direct investment activities of its persons aimed at acquiring foreign technology with respect to sectors and industries targeted by its industrial plans that create distortion."

The Chapter includes several additional disciplines aimed at prohibiting specific methods of forced technology transfer. For example, Article 2.2 provides that a Party may not "require or pressure persons of the other Party to transfer technology to its persons in relation to acquisitions, joint ventures, or other investment transactions." Article 2.3 prohibits a Party from adopting or maintaining "administrative and licensing requirements and processes" that require or pressure technology transfer from persons of the other Party to its persons. In addition, the Chapter prohibits a Party from requiring or pressuring, "formally or informally", that persons of the other Party transfer technology to its persons (or favor domestic technologies) as a condition for receiving market access, administrative or licensing approvals, or "any advantages conferred" by the Party. While there is some overlap between these requirements and the commitments that China already has assumed under Article 7.3 of its Protocol of Accession to the WTO, the Phase One Agreement's technology transfer terms are more detailed and expressly prohibit a wider range of government actions. On the other hand, China has long maintained that it does not impose technology transfer requirements, and the policing of informal requirements – a primary US business complaint – may prove difficult, especially at the sub-national level.

Agriculture

The Agriculture Chapter includes commitments related to biotechnology, domestic support, and tariff-rate quota administration. Notable provisions include a commitment by China to implement a "transparent, predictable, efficient, science- and risk-based regulatory process" for the evaluation and authorization of agricultural biotechnology, and to reduce the timeframe for review and authorization of products for feed or further processing to an average of 24 months. In addition, the Chapter contains extensive commitments related to sanitary and phytosanitary measures for specific products, including meats, poultry, seafood, dairy, and rice, among other items. However, other provisions of the Chapter merely reaffirm China's existing WTO obligations (*e.g.*, to publish information regarding its domestic support measures and to administer tariff-rate quotas for wheat, rice, and corn in conformity with the WTO Panel Report in *China—TRQs* (*DS517*)).

Expanding Trade

One of the more novel elements of the Phase One Agreement is the Chapter on "Expanding Trade", in which China has committed to increase purchases of goods and services from the United States during the two-year period from January 1, 2020 through December 31, 2021. During this time, China "shall ensure" that purchases and imports into China from the United States of certain manufactured goods, agricultural goods, energy products, and services identified in Annex 6.1 to the Agreement "exceed the corresponding 2017 baseline amount by no less than $200 billion." The Agreement further establishes purchase targets by product category (for agricultural goods, for example, China must ensure that "no less than $12.5 billion above the corresponding 2017 baseline amount is purchased and imported into China from the United States in calendar year 2020, and no less than $19.5 billion above the corresponding 2017 baseline amount is purchased and imported into China from the United States in calendar year 2021[.]" China's compliance with these commitments will be determined based on "Official Chinese trade data and official U.S. trade data[.]"

Although China's purchase commitments could result in a significant financial windfall for US exporters, they also raise concerns. For example, Article 6.2.5 of the Agreement states that "purchases will be made at market prices based on commercial considerations", but some traders have reportedly questioned whether certain targets (*e.g.*, oil & gas) are feasible given market conditions in China and the United States. Moreover, because the Agreement does not require China to complete the covered transactions in accordance with its WTO obligations, other WTO

Members, particularly those with exporters that compete directly with US exporters of the targeted goods, may question whether China's purchase commitments are consistent with WTO rules.

Financial Services

The Financial Services Chapter includes commitments related to banking, credit rating services, electronic payments, and insurance, among other issues. Key provisions of the Chapter include commitments by China to eliminate by April 1, 2020 its foreign equity caps for (1) securities companies, (2) suppliers of life, health, and pension insurance, (3) fund management services, and (4) futures services, and to refrain from imposing certain discriminatory measures in such sectors. Observers have noted that most of these commitments reiterate commitments that China has made (and allegedly violated) in other contexts.

Currency

The Chapter on Macroeconomic Policies and Exchange Rate Matters and Transparency includes a commitment by the Parties to "refrain from competitive devaluations and not target exchange rates for competitive purposes, including through large-scale, persistent, one-sided intervention in exchange markets." However, this commitment is largely the same as that agreed by the G-20 in 2016. Other provisions of the Chapter, moreover, are aspirational or merely reaffirm the Parties' commitments under the IMF Articles of Agreement to avoid manipulating exchange rates.

Bilateral Evaluation and Dispute Resolution

Chapter 7 of the Agreement sets forth a "dispute resolution" process that will apply where one Party believes the other Party has not acted in accordance with the Agreement. Unlike most modern trade agreements, the Chapter does not provide for the establishment of independent panels to adjudicate such disputes and authorize any countermeasures. Rather, the Agreement establishes a process of "consultations", whereby the Parties will attempt to resolve the issue through bilateral discussions among officials that will be designated by each Party. If the dispute cannot be resolved by the designated officials, the concerns may be raised to the designated Deputy United States Trade Representative and the designated Vice Minister of China. If the dispute is not resolved at the deputy or vice-ministerial level, the Complaining Party may present the issue to the United States Trade Representative and the designated Vice Premier of China. Once the dispute is raised to this level, the following procedures will apply:

- If the issue is not resolved at the USTR-Vice Premier level, the Parties "shall engage in expedited consultations on the response to the damages or losses incurred by the Complaining Party." If the Parties reach consensus on a response, the response shall be implemented.
- If the Parties do not reach consensus on a response, the Complaining Party "may resort to taking action based on facts provided during the consultations, including by suspending an obligation under this Agreement or by adopting a remedial measure in a proportionate way that it considers appropriate with the purpose of preventing the escalation of the situation and maintaining the normal bilateral trade relationship."
- If the responding Party considers that the action by the complaining Party "was taken in good faith", the responding Party "may not adopt a counter-response, or otherwise challenge such action." If the responding Party considers that the action of the Complaining Party "was taken in bad faith, the remedy is to withdraw from this Agreement by providing written notice of withdrawal to the Complaining Party."

Thus, as expected, the Agreement provides that each Party may unilaterally determine (1) whether the other Party has violated the Agreement; and (2) what measures it will take in response, which include but are not limited to suspending concessions under the Agreement. For example, by authorizing a Party to take "a remedial measure…that it considers appropriate" in response to a perceived violation of the Agreement, the Chapter would appear to permit a Party to impose additional tariffs on products of the other Party, provided that this action is "proportionate" to the violation and the issue is not resolved through consultations. Any US retaliation under the

dispute resolution provisions would likely entail such measures, rather than a suspension of US concessions under the Agreement, given that the United States' concessions under the Agreement are limited. In the event that China perceived such an action to be illegitimate, the only response expressly authorized would be withdrawal from the Agreement. However, given the limited nature of the United States' concessions under the Agreement, this structure raises questions as to whether the Agreement itself incentivizes China to comply fully with its commitments, especially over the long-term.

Entry Into Force and Termination

The Agreement will enter into force "within 30 days of signature by both Parties or as of the date on which the Parties have notified each other in writing of the completion of their respective applicable domestic procedures, whichever is sooner." Thus, the Agreement will enter into force by February 14, 2020, at the latest. Either Party may terminate the Agreement by providing written notice of termination to the other Party. The termination will take effect 60 days after the date of such a notice, or on another mutually agreed date.

Outlook

The signing of the Phase One Agreement is an important development that appears likely to prevent further, significant escalation of the US-China trade dispute, at least for the time being. However, it leaves unaddressed many key "structural issues" that the United States has prioritized, including China's provision of subsidies to its manufacturing sector and its involvement in the economy through state-owned enterprises (SOEs). Both sides have indicated that they are willing to continue negotiations for a "Phase Two" agreement, but it appears unlikely that a second agreement addressing more sensitive issues such as subsidies and SOEs can be concluded quickly, if at all. The Phase One Agreement contains no firm commitments in this regard (stating only that "[t]he Parties will agree upon the timing of further negotiations), and substantive discussions on Phase Two may be delayed while the Parties focus on the implementation of Phase One. It therefore appears likely that the vast majority of the United States' Section 301 tariffs and China's retaliatory tariffs will remain in place for the foreseeable future, as will the existing domestic procedures for tariff exclusions.

The United States also is likely to closely scrutinize China's implementation of the Phase One Agreement, which could lead to disputes and unilateral measures that could re-escalate tensions and potentially result in termination of the Agreement. The text of the Agreement also raises new questions about whether and to what extent China can and will comply with the Agreement over the longer term, as noted above. Thus, while the Phase One Agreement will likely avert further escalation of tariffs in the near future, significant trade restrictions, uncertainty, and the possibility for further escalation will persist over the longer term.

The text of the Phase One Agreement is available **here**.

Section 232

President Trump Issues Proclamation Extending Section 232 Duties to "Derivative" Steel and Aluminum Products

On January 24, 2020, President Trump issued a Proclamation expanding the scope of the Section 232 duties on steel and aluminum imports to cover certain "derivative" steel and aluminum products that were not subject to such duties when they were first implemented in 2018. As a result, the derivative steel and aluminum products listed in the Proclamation – which include certain steel nails, aluminum wire and cable, and motor vehicle components – will be subject to Section 232 duties of 25 and 10 percent, respectively, beginning on February 8, 2020, unless they originate from a country that already is exempt from Section 232 duties (*i.e.*, Argentina, Australia, Brazil, Canada, Mexico, and South Korea). According to the Proclamation, this action is being taken in response to an increase in imports of the derivative articles that, in the view of the administration, constitutes "circumvention" of the initial

Section 232 measures and is "undermining the effectiveness" of those measures. We provide an overview of the Proclamation below.

"Derivative" articles newly subject to Section 232 duties

Section 232 (19 U.S.C. § 1862(c)) permits the President, after receiving a Commerce Department report finding that an "article is being imported into the United States in such quantities or under such circumstances as to threaten to impair the national security," to adjust imports of the article and "its derivatives… so that such imports will not threaten to impair the national security." However, the statute does not define "derivative" or provide any further guidance on the adjustment of "derivatives" following the imposition of import restrictions on the subject "article."

According to the Proclamation, an article is "derivative" of an aluminum article or steel article if all of the following conditions are present:

- The aluminum article or steel article represents, on average, two-thirds or more of the total cost of materials of the derivative article;
- Import volumes of such derivative article increased year-to-year since June 1, 2018, following the imposition of the tariffs, in comparison to import volumes of such derivative article during the 2 preceding years; and
- Import volumes of such derivative article following the imposition of the tariffs exceeded the 4 percent average increase in the total volume of goods imported into the United States during the same period since June 1, 2018.

The list of "derivative" steel and aluminum products covered by the Proclamation includes: (1) certain steel nails, tacks, drawing pins and staples; (2) certain stranded wire, cables, and plaited bands of aluminum; (3) certain steel and aluminum bumper stampings for motor vehicles; and (4) certain steel and aluminum body stampings for agricultural equipment. The full list of the covered products and HTSUS subheadings is provided in the table below.

Category	"Derivative" Article
Steel	Nails, tacks (other than thumb tacks), drawing pins, corrugated nails, staples (other than those of heading 8305) and similar articles, of iron or steel, whether or not with heads of other material (excluding such articles with heads of copper), suitable for use in powder-actuated handtools, threaded (described in subheading 7317.00.30)
	Nails, tacks (other than thumb tacks), drawing pins, corrugated nails, staples (other than those of heading 8305) and similar articles, of iron or steel, whether or not with heads of other material (excluding such articles with heads of copper), of one piece construction, whether or not made of round wire; the foregoing described in statistical reporting numbers 7317.00.5503 7317.00.5505, 7317.00.5507, 7317.00.5560, 7317.00.5580 or 7317.00.6560 only and not in other statistical reporting numbers of subheadings 7317.00.55 and 7317.00.65;
	Bumper stampings of steel, the foregoing comprising parts and accessories of the motor vehicles of headings 8701 to 8705 (described in subheading 8708.10.30);
	Body stampings of steel, for tractors suitable for agricultural use (described in subheading 8708.29.21).

Category	"Derivative" Article
Aluminum	Stranded wire, cables, plaited bands and the like, including slings and similar articles, of aluminum and with steel core, not electrically insulated; the foregoing fitted with fittings or made up into articles (described in subheading 7614.10.50)
	Stranded wire, cables, plaited bands and the like, including slings and similar articles, of aluminum and not with steel core, not electrically insulated; the foregoing comprising electrical conductors, not fitted with fittings or made up into articles (described in subheading 7614.90.20)
	Stranded wire, cables, plaited bands and the like, including slings and similar articles, of aluminum and not with steel core, not electrically insulated; the foregoing not comprising electrical conductors, not fitted with fittings or made up into articles (described in subheading 7614.90.40);
	Stranded wire, cables, plaited bands and the like, including slings and similar articles, of aluminum and not with steel core, not electrically insulated; the foregoing fitted with fittings or made up into articles (described in subheading 7614.90.50)
	Bumper stampings of aluminum, the foregoing comprising parts and accessories of the motor vehicles of headings 8701 to 8705 (described in subheading 8708.10.30)
	Body stampings of aluminum, for tractors suitable for agricultural use (described in subheading 8708.29.21)

US imports of these products totaled approximately $883.3 million in 2018, though nearly one-third of this amount originated from Canada and Mexico, which are among the countries exempted from the new duties. The largest import sources of products classified in these subheadings (excluding countries that are fully or partially exempt from the new duties) are Taiwan, China, Oman, Japan, India, Turkey, and Thailand.

Expansion of Section 232 duties, country exemptions, and product exclusions

The Proclamation provides that imports of the derivative steel and aluminum articles listed above will be subject to Section 232 duties of 25 and 10 percent, respectively, where they are entered for consumption or withdrawn from warehouse for consumption on or after 12:01 a.m. eastern standard time on February 8, 2020, subject to the following exceptions:

- Imports of the covered derivative aluminum articles from Argentina, Australia, Canada, and Mexico will not be subject to Section 232 duties; and
- Imports of the covered derivative steel articles from Argentina, Australia, Brazil, Canada, Mexico, and South Korea will not be subject to Section 232 duties.

The country exemptions described above represent a continuation of existing policy with respect to Australia, Canada, and Mexico, whose exports the administration has exempted from Section 232 restrictions entirely. On the other hand, the new exemptions are more liberal than current policy for imports of aluminum from Argentina and imports of steel from Argentina, Brazil, and South Korea, which are subject to product-specific, absolute quotas under Section 232. It is therefore notable that, for the time being, the administration has determined not to apply any Section 232 restrictions (quotas or duties) to the listed derivative steel products from Argentina, Brazil, or South Korea, or to the listed derivative aluminum products from Argentina. However, the Proclamation authorizes the

Secretary of Commerce to impose such restrictions in the future "in the event of a surge of imports of any [covered derivative article] from any excepted country[.]" In such a scenario, the Secretary of Commerce "with the concurrence of the USTR" is authorized "to extend application of the tariff…on imports of any derivative article experiencing such surge from such country, or to adopt appropriate quotas for imports of such derivative article from such country, or to negotiate a voluntary agreement with such country to ensure that imports of such derivative article from such country do not undermine the effectiveness" of the Section 232 action.

The Proclamation also provides that imports of the covered derivative articles will be eligible for product-specific exclusions from the Section 232 duties under the exclusion process administered by the Department of Commerce. As with other steel and aluminum products subject to Section 232 duties, the derivative products will be eligible for exclusions (1) if they are not produced in the United States in a sufficient and reasonably available amount or of a satisfactory quality; or (2) based upon specific national security considerations.

Stated basis for expanding Section 232 duties

The Proclamation justifies the expanded scope of the Section 232 duties based on two findings by the Department of Commerce:

- Despite the imposition of the Section 232 duties in March 2018, "domestic steel producers' capacity utilization has not stabilized for an extended period of time at or above the 80 percent capacity utilization level identified in his report as necessary to remove the threatened impairment of the national security." In addition "[c]apacity utilization in the aluminum industry has improved, but it is still below the target capacity utilization that the Secretary recommended in his report."
- Foreign producers of the derivative articles "have increased shipments of such articles to the United States to circumvent [the existing Section 232 duties]", and imports of these derivative articles "threaten to undermine the actions taken to address the risk to the national security" found in the President's original Section 232 determinations. In particular, "[t]he net effect of the increase of imports of these derivatives has been to erode the customer base for U.S. producers of aluminum and steel[.]"

Based on these assessments, the President concluded "that it is necessary and appropriate in light of our national security interests to adjust the tariffs imposed by previous proclamations to apply to the [covered derivative products]." This action, in the view of the President, is "necessary and appropriate to address circumvention that is undermining [the Section 232 measures] and to remove the threatened impairment of the national security" found to exist in the original Section 232 proclamations.

Outlook

The administration's decision to expand the scope of the Section 232 duties is notable in several respects. First, the Proclamation expressly acknowledges that, nearly two years after the Section 232 duties' imposition and contrary to public statements from several administration officials, the import restrictions have not yet achieved the administration's stated economic objectives. Second, the Proclamation acknowledges, and appears to be aimed at mitigating, a widely-expected consequence of the Section 232 duties, i.e., that they have placed US manufacturers of downstream products containing steel and aluminum at a competitive disadvantage with respect to their foreign competitors, who are able to purchase steel and aluminum inputs at global prices. The administration's decision to address this issue by expanding the scope of the Section 232 duties to "derivative" products represents a "doubling-down" on its current approach, and may presage similar actions targeting imports of other steel- and aluminum-intensive goods (e.g., those that also qualify under the administration's definition of "derivative" based on new import data).

Third, while the Proclamation addresses "circumvention" by "derivative" goods following the imposition of an import adjustment measure under Section 232 (19 U.S.C § 1862(c)), there is no specific statutory language addressing this situation. In fact, the Proclamation does not explain how such "derivative" imports were "circumventing" the original Section 232 measures, and the original Section 232 Proclamations implementing the tariffs do not mention "derivatives" of the steel and aluminum "articles" covered by the Section 232 measures. In the antidumping (AD) and countervailing duty (CVD) context, "circumvention" may be found where a product is (1) completed or assembled in the US from foreign parts; (2) completed or assembled from foreign parts in a third country; (3) altered with minor changes from a product subject to an AD/CVD order; or (4) developed after an AD/CVD investigation, but is similar to a product that is subject to an AD/CVD order. It is unclear if the Trump administration is relying on any of these bases for its determination of "circumvention." Regardless, the new Proclamation is consistent with past Trump administration statements regarding alleged "circumvention" of US tariffs.

Finally, it is possible that this latest modification of the Section 232 action will be challenged in US courts, particularly given the views expressed by the US Court of International Trade in its November 15, 2019 preliminary opinion in Transpacific Steel LLC v. United States. In that opinion, the Court cast doubt on the President's legal authority to modify import restrictions imposed under 19 U.S.C. § 1862(c) once they have been decided and the statutory deadlines for imposing such restrictions have passed. Though the CIT case remains ongoing and concerns a different modification of the Section 232 action (the doubling of the Section 232 tariff rate on steel from Turkey), the preliminary opinion shows some willingness on the part of the CIT to consider whether the law permits the President to modify significantly Section 232 import adjustment actions on an ongoing basis.

The Proclamation can be viewed **here**. The Annexes listing the covered derivative products are available **here** (for steel) and **here** (for aluminum).

US Department of Justice Issues Slip Opinion Concerning Section 232 Autos Case

In a January 17, 2020 slip opinion from the US Justice Department, the Trump administration has confirmed that, contrary to past public statements from White House officials that the Section 232 investigation of automotive goods is now closed, the administration believes that the case remains ongoing and could therefore still result in a future presidential "action" restricting imports. The DOJ slip opinion was used to support a Commerce Department announcement that it would not comply with a new statutory requirement, set forth in the Consolidated Appropriations Act of 2020, to publish the Section 232 report on automotive goods by January 19, 2020. In the opinion, DOJ relies upon an expansive and untested interpretation of the Section 232 statute to argue that, after directing the Office of the US Trade Representative (USTR) in May 2019 to enter into negotiations with foreign countries to address the purported national security threat, the President retains the ability to take "other actions" in the investigation and faces no statutory deadline to do so. Most notably, DOJ states:

> *USTR advises that negotiations remain ongoing, but have not yet produced an agreement that addresses the national-security threat. We are also advised that the President has not yet decided what, if any, "other actions" to take under section 232(c)(3)(A) to adjust imports of automobiles and automobile parts, including whether to impose tariffs or quotas on those imports. In view of pending international negotiations and executive branch deliberations, the Secretary of Commerce has not yet published his report. (pp. 4-5)*
>
> *…*
>
> *The statute continues to authorize the President to take action to adjust imports of automobiles and automobile parts under section 232. Following the Secretary's initial transmission of the report, the President had 90 days to decide whether he concurred in the Secretary's findings and to determine what action to take in response. Id. § 1862(c)(1)(A). Once the President decided to address the threat by ordering negotiations, he had 15 days to implement that action. Id. § 1862(c)(1)(B). Because the resulting negotiations did not*

> *produce an agreement within 180 days, the President is now authorized to "take such other actions as the President deems necessary to adjust imports of such article so that such imports will not threaten to impair the national security." Id. § 1862(c)(3)(A).*
>
> *There is, however, no statutory deadline for the President to exercise that power. Congress specifically amended the statute in 1988 to add some specific deadlines for the President to act in response to the Secretary's report—the 90- and 15-day periods noted above. See Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 1501(3), 102 Stat. 1107, 1258. But in contrast with the President's initial determination, which must be made "[w]ithin 90 days" and "implement[ed] . . . by no later than" 15 days after the determination, 19 U.S.C. § 1862(c)(1)(A), (B), the statute does not set any further deadline for presidential action after the conclusion of the 180-day negotiation period. In giving the President the discretion to take "such other actions as the President deems necessary" after that period, id. § 1862(c)(3)(A), Congress did not require the President to act within any particular timeframe. It instead provided him with discretion to shape an appropriate action, including with respect to continuing the international negotiations that are the basis for invoking this part of section 232. Here, the decision-making process expressly contemplated by section 232 remains ongoing, giving the Executive Branch a strong confidentiality interest in predecisional, deliberative material relevant to the ongoing process of deciding how to exercise that authority. (p. 11)*

Although the DOJ opinion relates to the confidentiality of the report, the administration could employ the same arguments in an attempt to justify a new "action" against certain automotive imports in the future, and President Trump in recent weeks has continued to threaten the European Union with automobile tariffs. On the other hand, any major Section 232 action targeting automotive imports broadly, especially from non-EU countries, seems unlikely this year given the upcoming election, and it would likely face challenges in US courts. Nevertheless, the DOJ opinion remains a clear confirmation from the administration that, in its view, the Section 232 investigation is not closed.

CFIUS

CFIUS Finalizes New FIRRMA Regulations

By Farhad Jalinous, Karalyn Mildorf, Keith Schomig, Stacia J. Sowerby, Sandra Jorgensen, and Ata Akiner

Nearly a year and a half after the Foreign Investment Risk Review Modernization Act of 2018 (FIRRMA) was enacted, authorizing the most substantial overhaul of the Committee on Foreign Investment in the United States (CFIUS) process since its inception, CFIUS has released final FIRRMA implementing regulations. This alert describes the key features of the new regulations, which take effect on February 13, 2020, including notable changes to the proposed regulations issued in September 2019 (see our prior alert **here**). The final regulations largely retain the framework set forth in the proposed regulations—including implementing the expansion of CFIUS's authority while maintaining CFIUS review as a mostly voluntary process—but make certain significant changes, codify the critical technology pilot program (subject to new exemptions), offer some clarification and guidance, and promise additional changes to come.

As we previously reported in **July** and **August** 2018, FIRRMA provided the general contours for CFIUS reform – including new jurisdiction over certain non-controlling investments and real estate transactions; limitation of such expanded jurisdiction to certain categories of foreign investors; a new short-form filing and review process; and mandatory filing requirements for certain transactions involving foreign government interest or critical technologies – but largely deferred to CFIUS itself to define the precise extent of such reforms. CFIUS did so in September 2019 when it issued two sets of proposed regulations addressing investment and real estate rules, often in the form of highly specific bright-line criteria. With some modifications, the final regulations maintain this framework, which reflects efforts by CFIUS to limit the expansion of its jurisdiction and mandatory filing requirements only to those transactions most likely to raise national security concerns. Notably, the final regulations further limit the expansion of CFIUS's jurisdiction and mandatory filing requirements by loosening the requirements to be an "excepted investor" and by adding a number of exemptions to mandatory filing requirements for investments in companies involved with critical technologies.

FIRRMA does not change CFIUS's core risk-based analysis of each reviewed transaction, which assesses the "threat" posed by the foreign investor, the "vulnerability" exposed by the US business, and the national security consequences of combining that threat and vulnerability. Overall, however, the new CFIUS regime requires a substantially more complex, nuanced, and fact-intensive analysis for jurisdictional questions – including whether filing is mandatory – while retaining the long-standing challenges of assessing and allocating potential substantive national security risks in connection with the CFIUS review process.

The following summarizes the key aspects of the new CFIUS regulations, which take effect on February 13, 2020.

Expanded Jurisdiction

Prior to FIRRMA, CFIUS's jurisdiction was limited to transactions that could result in foreign control of any US business. As a result, the jurisdictional analysis was largely legal in nature: did the investor's ownership structure make it a "foreign person"; could the investor's governance rights result in "control"; and did the target company or assets constitute a "US business"? There was little, if any, need to consider the *substantive* national security vulnerabilities of the target to complete the *jurisdictional* analysis. Historically, the substantive assessment would typically be considered in assessing whether to file and potential risks relating to such a decision where jurisdiction was clear or presumed.

FIRRMA retains CFIUS's jurisdiction over such transactions (referred to as "covered control transactions") but gives CFIUS two new bases for jurisdiction: (1) certain non-controlling investments in certain US businesses involved with critical technology, critical infrastructure, or sensitive personal data (known as "TID US businesses" for technology, infrastructure, and data), and (2) certain real estate transactions. The regulations provide detailed criteria of a US business's operations or the real estate assets, as applicable, that would cause a transaction to fall within these new bases for jurisdiction. As a result, under the new framework, the *jurisdictional* analysis for non-controlling transactions will require a *substantive* assessment of the target business against these detailed criteria.

The criteria for subjecting transactions to CFIUS's expanded jurisdiction reflect the types of US businesses or real estate assets that have presented heightened national security vulnerabilities in CFIUS's caseload over the past years as well as the US government's growing concern with maintaining the integrity and reliability of the defense industrial base. We summarize these criteria below.

<u>Covered Investments</u>

CFIUS's jurisdiction to review certain non-controlling, yet non-passive investments (called "covered investments" in the regulations) is based on both the nature of the investment and the nature of the target US business. FIRRMA supplied the first half of the test: the nature of the investment must afford a foreign person (other than a foreign person that meets a detailed list of criteria, referred to as an "excepted investor") one or more of the following:

a. access to any material non-public technical information in the possession of the TID US business;

b. membership or observer rights on the board of directors (or equivalent) of the TID US business or the right to nominate an individual to a position thereto; or

c. any involvement, other than through voting of shares, in substantive decision-making of the TID US business regarding critical technology, critical infrastructure, or sensitive personal data.

The new regulations supply the second half of the test by defining with more particularity what is required to be a "TID US business." The three categories of TID US businesses are as follows:

1. *Critical Technology*

A US business that produces, designs, tests, manufactures, fabricates, or develops one or more "critical technologies" is considered a "TID US business." The regulations maintain without change or additions the definition of "critical technology" in FIRRMA, which includes: defense articles and defense services included on the United States Munitions List; certain items included on the Commerce Control List (CCL); certain nuclear-related facilities, equipment, parts and components, materials, software, and technology; select agents and toxins; and emerging and foundational technologies controlled for export pursuant to section 1758 of the Export Control Reform Act of 2018

(ECRA). As of the date of this alert, the Commerce Department has issued its first emerging technology control – on software specially designed to automate the analysis of geospatial imagery. We understand that export controls on additional emerging technologies will be released in the near term, including in the areas of biomedical, semiconductor, 3D printing, and quantum computing technologies.

2. *Critical Infrastructure*

FIRRMA instructs CFIUS to limit its jurisdiction over covered investments in "critical infrastructure" to a subset of critical infrastructure (referred to in the regulations as "covered investment critical infrastructure") that is likely to be of particular importance to US national security. The regulations define this subset with precise bright lines – but with many such lines – in a detailed appendix that identifies *28 types* of infrastructure. These include:

- **telecoms:** certain internet protocol networks, telecommunications and information services, internet exchange points, submarine cable systems and related facilities (including certain data centers);
- **power:** certain systems for the generation, transmission, distribution, or storage of electric energy comprising the bulk-power system, industrial control systems utilized therefor, and certain electric storage resources physically connected to the bulk-power system;
- **oil and gas:** certain refineries, crude oil storage facilities, liquid natural gas (LNG) import or export terminals, natural gas underground storage facilities or LNG peak-shaving facilities, interstate oil and natural gas pipelines, and industrial control systems therefor;
- **water:** certain public water systems and treatment works, and industrial control systems therefor;
- **finance:** certain systemically important financial market utilities, securities and options exchanges, and core processing services providers;
- **defense industrial base:** fiber optic cables that directly serve certain military installations; facilities that provide electric power generation, transmission, distribution, or storage directly to or located on certain military installations and industrial control systems therefor; public water systems or treatment works directly serving certain military installations and industrial control systems therefor; interstate oil pipelines that directly serve the strategic petroleum reserve; rail lines and associated connector lines designated as part of the Department of Defense's (DOD) Strategic Rail Corridor Network; satellites or satellite systems providing services directly to DOD and its components; facilities in the United States that manufacture certain specialty metals, covered materials, chemical weapons antidotes, and carbon, alloy, and armor steel plate; and – other than commercially available off-the-shelf items – certain industrial resources manufactured or operated for a Major Defense Acquisition Program, Major System, or "DX" priority-rated contract or order, or funded by the Title III program, Industrial Base Fund, Rapid Innovation Fund, Manufacturing Technology Program, Defense Logistics Agency (DLA) Warstopper Program, or a DLA Surge and Sustainment contract; and
- **ports:** airports and maritime ports that are subject to CFIUS's new real estate jurisdiction.

The appendix also assigns one or more of five specified functions (own, operate, supply, service, or manufacture) to each of the 28 types of infrastructure. A US business that performs at least one of the *functions* assigned to the corresponding *type* of covered investment critical infrastructure is considered a "TID US business."

3. *Sensitive Personal Data*

FIRRMA contains no definitions or delineating principles with respect to "sensitive personal data," other than that it refers to data that may be exploited in a manner that threatens national security. To address this, the regulations create two classes of sensitive personal data.

First, sensitive personal data includes the results of an individual's genetic tests, including any related genetic sequencing data, whenever such results constitute "identifiable data" (discussed below) – regardless of the amount of such data or the population on which it is collected. This definition excludes data derived from databases maintained by the US government and routinely provided to private parties for purposes of research and generally reflects a narrowing of the types of genetic information that would have been captured under the proposed regulations issued last fall.

Second, sensitive personal data includes "identifiable data," which is defined as data that can be used to distinguish or trace an individual's identity – but only if the following *category* and *collection* requirements are satisfied:

- **Categories:** the identifiable data falls within one of 10 identified categories, which are: (a) financial data that could be used to determine an individual's financial distress or hardship; (b) data in a consumer report (with certain exceptions); (c) data included in health or other types of insurance applications; (d) data relating to the physical, mental, or psychological health of an individual; (e) non-public electronic communications (email, text, chat, etc.) between users of the US business's products or services if facilitating third-party user communications is a primary purpose of such products or services; (f) geolocation data; (g) biometric enrollment data; (h) data used to generate a state or federal government ID card; (i) data concerning US government personnel security clearance status, or (h) data contained in the application for a personnel security clearance or for employment in a position of public trust.

- **Collection:** the US business that maintains or collects the identifiable data (a) targets or tailors products or services to any US executive branch agency or military department with intelligence, national security, or homeland security responsibilities, or to personnel and contractors thereof; (b) had such data on greater than one million individuals at any point over the 12 months preceding the earliest of the "completion date" of the transaction, execution of a binding transaction agreement, the submission of a CFIUS notice or declaration, or certain other transaction-related actions (unless it can demonstrate no ability to collect or maintain any such data as of the completion date); or (c) has a demonstrated business objective to maintain or collect such data on greater than one million individuals *and* such data is an integrated part of the US business's products or services.

Any US business that maintains or collects either class of "sensitive personal data," with limited exceptions (e.g., such data on the employees of the US business or available in the public domain), is considered a "TID US business."

<u>Covered Real Estate Transactions</u>

FIRRMA also gave CFIUS jurisdiction to review the purchase or lease by, or concession to, a "non-excepted" foreign person of certain real estate (a) located within or functioning as part of an air or maritime port or (b) that is in close proximity to, or that provides the foreign person the ability to collect intelligence on or surveil national security activities at, US military installations or other sensitive US government facilities or property.

The regulations implement this new basis for jurisdiction through the concept of a "covered real estate transaction." Specifically, unless any of the eight exceptions listed below applies, CFIUS has the authority to review any purchase or lease by, or concession to, a foreign person of "*covered real estate*," either directly or indirectly, that affords the foreign person at *least three* of the following four "*property rights*":

- physically access the real estate;
- exclude others from physically accessing the real estate;
- improve or develop the real estate; or
- attach fixed or immovable structures or objects to the real estate.

"Purchase" includes less than full ownership of the covered real estate. A "lease" includes a sub-lease. "Concessions" only pertain to the development or operation of infrastructure for certain air or maritime ports.

There are five types of "covered real estate":

1. real estate that is located within, or will function as part of, certain air or maritime ports (referred to in the regulations as "covered ports");

- "airports" are limited to (i) any "large hub airport," as defined in 49 U.S.C. § 40102, listed in the Department of Transportation (DOT), Federal Aviation Administration's (FAA) annual final enplanement data, (ii) any airport with annual aggregate all-cargo landed weight greater than 1.24 billion pounds listed in the FAA's annual final all-cargo landed weight data, and (iii) any "joint use airport" as defined in 49 U.S.C. § 47175 listed by the FAA.
- "maritime ports" are limited to (i) commercial strategic seaports within the National Port Readiness Network, and (ii) the top 25 tonnage, container, or dry bulk ports listed by the DOT's Bureau of Transportation Statistics.

2. real estate that is within "close proximity" (defined as one mile) of any military installation listed on part 1 (131 such sites) or part 2 (32 such sites) of Appendix A to the real estate regulations;

3. real estate that is within the "extended range" (defined as up to 100 miles but where applicable not exceeding the outer limit of the US territorial sea) of any military installation listed on part 2 of Appendix A. These 32 military installations generally cover expansive territory and contain sensitive training ranges or launch sites susceptible to physical or electronic surveillance. These sites include, for example, Naval Weapons Systems Training Facility Boardman, Oregon, which was relevant to a Presidential divestment order in 2012 on the basis of a CFIUS review in the Ralls transaction;

4. real estate located within any of the 48 counties or other geographic areas listed on part 3 of Appendix A, which are associated with missile fields and were expanded to cover more area than was originally listed in the proposed regulations; and

5. real estate located within any part of the 23 offshore military operating areas listed on part 4 of Appendix A, but only to the extent located within the limits of the US territorial sea (i.e., generally 12 nautical miles from the coastline).

In an effort to streamline what could otherwise be a countless number of "covered real estate transactions," which would be unworkable for both industry and CFIUS, the regulations include eight important exceptions:

1. A blanket exemption from "covered real estate transactions" for certain categories of foreign persons known as "excepted real estate investors" (see next section, below).

2. Any transaction involving covered real estate that is a covered transaction subject to CFIUS's investment-related jurisdiction. Any transaction involving the acquisition of, or an investment in, a US business must be analyzed under CFIUS's "covered control transaction" or "covered investment" jurisdiction, described above, and would not be

considered a "covered real estate transaction" even if it includes covered real estate. In other words, "covered real estate transactions" only apply to transactions involving real estate that does not constitute a US business.

3. Any covered real estate that is within an "urbanized area" or "urban cluster," each as identified in the most recent US Census, unless the real estate either (i) is located within, or will function as part of, a covered port, or (ii) is within close proximity (i.e., one mile) of any military installation listed on part 1 or part 2 of Appendix A to the real estate regulations.

4. All single housing units, including fixtures and adjacent land that are incidental to the use of the real estate as a single housing unit.

5. Leases or concessions to a foreign air carrier for which the Transportation Security Administration has accepted a security program under 49 CFR § 1546.105, but only to the extent the lease or concession is in furtherance of its activities as a foreign air carrier. This exception was added to the final regulations on the basis that such foreign air carriers are already subject to Department of Homeland Security oversight.

6. Leases and concessions involving covered real estate at covered ports that may be used only for the purpose of engaging in the retail sale of consumer goods or services to the public. This is meant to exclude leases by retail vendors within an airport, including with respect to car rental and parking.

7. Commercial space in a multi-tenant building that is covered real estate, but only if, upon closing, the foreign person and its affiliates (i) do not, in the aggregate, exceed 10 percent of the total square footage and (ii) do not represent more than 10 percent of the total number of tenants based on the number of ownership, lease and concession arrangements for commercial space in the building. Notably, the final regulations removed the proposed rule's reference to "office" space, so this provision applies more clearly to the commercial space within a building generally, regardless of how it is used by tenants.

8. Covered real estate owned by certain Alaska Native entities or held in trust by the United States for American Indians, Indian tribes, Alaska Natives, and Alaska Native entities.

The real estate regulations are extremely detailed and could require a time- and fact-intensive assessment to determine whether a transaction falls within this new basis for CFIUS jurisdiction. We note, however, that "covered real estate transactions" are subject to *voluntary review* – they are not subject to the two categories of mandatory filing requirements described below. Additionally, the commentary accompanying the regulations states that the Treasury Department (which chairs CFIUS) "anticipates making available a web-based tool to help the public understand the geographic areas subject to CFIUS jurisdiction." In the meantime, it references online resources relevant to assessing coverage of the rule.

Limited Exemption from Expanded Jurisdiction for "Excepted Investors"

While FIRRMA instructs CFIUS to limit the application of the two new bases for jurisdiction (covered investments and covered real estate transactions) to certain categories of foreign persons, the regulations instead apply the new bases for jurisdiction to *all* foreign persons *unless* a foreign person is specifically exempted. The proposed rules issued last September did not identify countries for exemption and set forth extremely strict criteria to qualify as an excepted investor.

In connection with issuing the final regulations, CFIUS identified Australia, Canada, and the United Kingdom as "excepted foreign states." The final regulations also relaxed somewhat the standards for qualifying as an "excepted investor" (which are the same as for an "excepted real estate investor"), as discussed in more detail below.

The regulations provide no criteria for how CFIUS selects countries for the excepted foreign state list(s) (which may differ for investment and real estate transactions, but do not initially), other than that (i) they must be identified by CFIUS as an eligible foreign state and (ii) after February 13, 2022, including for existing excepted foreign states to remain on the list(s), CFIUS must have made a determination that the country has established and is effectively utilizing (or, with respect to real estate, made significant progress towards) a robust process to (a) analyze national security risks in foreign investment and (b) facilitate coordination with the United States on matters relating to investment security. The specific factors that CFIUS will consider as to whether a country has developed such a "robust process" in the future have not yet been determined.

It is not surprising that the initial list of excepted foreign states is small and limited to three of the four foreign "Five Eye" countries with special intelligence-sharing arrangements. Indeed, the commentary accompanying the regulations specifically notes that those countries were chosen "due to aspects of their robust intelligence-sharing and defense industrial base integration mechanisms with the United States." The commentary also acknowledged that the limited list reflects that the excepted foreign state rules "are new and an expansive application carries potentially significant implications for the national security of the United States." The list of excepted foreign states is not static and may change in the future.

The process to determine whether a particular foreign person is an "*excepted investor*" (or "*excepted real estate investor*") is complex and ultimately highly restrictive. To be an "excepted investor," the foreign person must fall into one of three categories:

1. A foreign national who is exclusively a national of one or more excepted foreign states.

2. A foreign government of an excepted foreign state.

3. A foreign entity that meets each of the following five criteria with respect to itself and *each of its parents*:

i. Organized under the laws of an excepted foreign state or in the United States.

ii. Principal place of business in an excepted foreign state or in the United States.

iii. Seventy-five percent or more of the members *and* 75 percent or more of the observers of its board of directors or equivalent governing body are either US nationals or foreign nationals who are exclusively a national of one or more excepted foreign states.

iv. Any foreign person that individually, or as part of a group of foreign persons, holds 10 percent or more of the voting interest, economic interest, profit interest, or asset-upon-dissolution interest or that could otherwise control such entity must be (a) a foreign national who is exclusively a national of one or more excepted foreign states, (b) a foreign government of an excepted foreign state, or (c) a foreign entity organized under the laws of an excepted foreign state and that has its principal place of business in an excepted foreign state or the United States.

v. The "minimum excepted ownership" of such entity – defined as a majority of its voting, profit, *and* asset-upon-dissolution interest for an entity publicly traded primarily on an exchange in an excepted foreign state or the United States; and at least 80 percent of its voting, profit, *and* asset-upon-dissolution interest for any other entity – must be held, individually or in the aggregate, by persons each of whom either is not a foreign person or qualifies as (a), (b), or (c) in criterion (iv) above.

Even if a foreign person meets all of the above criteria, it is still not an "excepted investor" if (a) it is listed on the Commerce Department, Bureau of Industry & Security's Unverified List or Entity List, or (b) in the five years prior to the completion of its transaction, either the foreign person or any of its parents or any entity of which it is a parent engaged in any of eight types of bad acts, including: material misstatements in a CFIUS filing, material breach of a

CFIUS mitigation agreement, violations of US sanctions laws, debarment by the Directorate of Defense Trade Controls, violations of US export control laws, and felonies. Further, if the foreign person no longer satisfies the criteria in (1), (2), and (3)(i)-(iii), above, at any time during the three-year period *after* the completion date of the transaction, it is no longer an "excepted investor" from the completion date onward, and its transaction would become subject to a potential CFIUS-initiated agency notice during the remainder of this three-year period.

Mandatory Filing Requirements

A key takeaway from both FIRRMA and the new regulations is that CFIUS remains primarily a voluntary process. Unless a transaction falls within either of the two specific categories below, the parties may decide for themselves whether to submit the transaction for CFIUS review. Though, importantly, CFIUS retains the right to initiate reviews of, or encourage parties to voluntarily submit for review, non-notified transactions.

As discussed in more detail below, there are two categories of transactions subject to mandatory filing requirements, both specific to TID US businesses. The first applies to investments by *any investor* (subject to certain exemptions) in *certain TID businesses* involved with *critical technologies*. The second pertains to certain investments by foreign investors with *substantial foreign government ownership* (subject to certain exemptions) in *any* TID US business.

Critical Technology Pilot Program Codified, With New Exemptions

In November 2018, CFIUS started a pilot program that mandated filings for covered control transactions and covered investments in certain US businesses involved with critical technologies in or for 27 specific "pilot program industries." (See our alert on the pilot program **here**.) The final FIRRMA regulations codify the requirements of the pilot program, including mandating filing for qualifying critical technology transactions, with some notable changes. Most significantly, the regulations introduce a number of exemptions to the mandatory filing requirements. Specifically, the following are not subject to mandatory notification:

1. A covered control transaction by an excepted investor (note: qualifying as an excepted investor already precludes the investor from being subject to the expanded jurisdiction for covered investments in TID US businesses);

2. A covered transaction (i.e., covered control transaction or covered investment) made directly by a company holding an active facility security clearance and operating pursuant to a Security Control Agreement, Special Security Agreement, Proxy Agreement, or Voting Trust Agreement to mitigate its foreign ownership, control or influence (FOCI);

3. A covered transaction by an investment fund if the fund is managed exclusively by a general partner (or equivalent) that is either not a foreign person or is ultimately controlled exclusively by US nationals and (as described in more detail below) to the extent any foreign limited partner serves on an advisory board or committee of the fund, such role would not allow the foreign limited partner to control the fund, its investment decisions, or decisions regarding the entities in which it has invested;

4. An investment that becomes a covered investment only because the investor ceases to meet the excepted investor criteria during the three-year period after the completion date;

5. A covered control transaction involving an air carrier that holds a general, temporary, or charter air transportation certificate (note: FIRRMA already carves out such carriers from "covered investments"); or

6. A covered transaction where the target only qualifies as a TID US business because it produces, designs, tests, manufactures, fabricates, or develops encryption items, software, or technology eligible for License Exception ENC under the Export Administration Regulations.

There are also two key changes in the regulations that impact the rules that applied to the pilot program. First, the filing of a declaration (or notice in lieu of a declaration) is required *30 days* before the "completion date," which reduces the pilot program's 45-day advanced notice period. Second, the regulations include a strict definition of "completion date," which is the earliest date upon which any ownership interest, including a contingent equity interest, is conveyed, assigned, delivered, or otherwise transfers to a person, or a change in rights that could result in a covered control transaction or covered investment occurs. While commentary in the final regulations suggests that the first date upon which a transfer of interest occurs is not the "completion date" unless such a transfer constitutes a "covered transaction," the definition itself is not clear. This lack of clarity creates uncertainty in the context of a transaction that has multiple tranches (which is common in venture capital and other early-stage investing) as to whether the closing of the first such tranche constitutes the "completion date" (including for purposes of the 30-day lead time by which a mandatory filing must be submitted), even if "control" or "non-passive" rights do not attach at the first closing.

Finally, the commentary accompanying the regulations states that CFIUS anticipates moving from a mandatory filing rule utilizing an industry test based on North American Industry Classification System (NAICS) codes to one based upon export control licensing requirements. A notice of proposed rulemaking regarding this change will be published in the future.

Substantial Foreign Government Interest in TID US Businesses

As required under FIRRMA, transactions involving the acquisition of a substantial foreign government interest in a TID US business are subject to mandatory filing requirements. Specifically, a short-form declaration, or a full notice in lieu of a declaration, must be submitted at least 30 days prior to the completion date of any covered control transaction or covered investment that results in:

- a "substantial interest" (defined as a *voting* interest, direct or indirect, of 25 percent or more) in a TID US business
- by a foreign person in which the national or subnational governments of a single foreign state (other than an excepted foreign state) have a "substantial interest" (defined as a *voting* interest, direct or indirect, of 49 percent or more).

For purposes of determining the percentage of voting interest held indirectly by one entity in another entity, any voting interest of a parent will be deemed to be 100 percent in its subsidiary. Thus, for the substantial-interest analysis, the regulations do not recognize dilution throughout the ownership chain that would otherwise result from parent ownership interests less than 100 percent.

The final regulations were modified to state that for an entity with a general partner, managing member, or equivalent, the substantial interest test is only satisfied if the government entity(ies) holds 49 percent or more of the *general partner, managing member or equivalent* – foreign government limited partner interests are disregarded.

The final regulations also provide exemptions from mandatory filing requirements for substantial foreign government ownership in two cases:

1. A covered transaction by an investment fund if the fund is managed exclusively by a general partner (or equivalent) that is either not a foreign person or is ultimately controlled exclusively by US nationals and (as described in more detail below) to the extent any foreign limited partner serves on an advisory board or committee of the fund, such role would not allow the foreign limited partner to control the fund, its investment decisions, or decisions regarding the entities in which it has invested; and

2. A covered control transaction involving an air carrier that holds a general, temporary, or charter air transportation certificate.

Penalties

Failure to make a mandatory filing may incur civil penalties not to exceed $250,000 or the value of the transaction, whichever is greater, with the amount of the penalty based on the nature of the violation. The Treasury Department is also considering whether it can make available additional information to assist the public in understanding CFIUS's enforcement priorities.

Please also note that while a mandatory filing must be made at least 30 days before the completion date, the regulations permit the parties to close their transaction prior to the expiration of the 30 days if they have been informed in writing by CFIUS either that (a) CFIUS has concluded all action, or (b) in the case of a declaration, CFIUS is not able to complete action on the basis of the declaration (but CFIUS does not request or self-initiate a full notice).

Investment Funds

There are a number of provisions in the regulations directly focused on, or primarily of relevance to, investment funds.

First, as noted above, there are certain exemptions to mandatory filing requirements for US-controlled investment funds. Specifically, transactions are exempt from both critical technology and substantial government interest mandatory filings if:

1. the fund is managed exclusively by a general partner, a managing member, or equivalent;

2. that general partner, managing member, or equivalent is not a foreign person; and

3. if any foreign person has membership as a limited partner on an advisory board or committee of the fund:

i. the advisory board or committee does not have the ability to approve, disapprove, or otherwise control (a) investment decisions of the investment fund or (b) decisions made by the general partner, managing member, or equivalent related to entities in which the investment fund is invested; and

ii. the foreign person does not otherwise have the ability to control the investment fund.

Also as noted above, the substantial interest test for an investment fund pertains only to government ownership in the general partner, managing member, or equivalent – foreign government limited partner interests do not trigger mandatory filing.

Second, the regulations, consistent with FIRRMA, include a "clarification" for certain investment fund investments in relation to participation by foreign limited partners on advisory boards or committees of the fund. As we have previously reported, this clarification means that a foreign limited partner's membership on an advisory board or committee of a fund does not, *in and of itself*, render the foreign person's indirect investment in a TID US business to be a covered control transaction or a covered investment *if it would not otherwise be*. Whether such indirect investment *would otherwise be* such a covered transaction would still need to be assessed based on the respective criteria for covered control transactions and covered investments. Indeed, the final regulations add an example clarifying that even if the investment fund is exempted under this clarification, a limited partner's indirect investment in the TID US business would be subject to a mandatory filing requirement if it is afforded a qualifying right regarding the TID US business.

Short-Form Declarations Can Be Filed for Any Transaction

As previously reported, one key new feature under FIRRMA is the ability for transaction parties to notify CFIUS via a declaration – a form that is approximately five pages in length – and receive feedback within 30 calendar days of CFIUS accepting the declaration. This is an alternative to submitting a full notice and going through the full prefiling and formal review processes, though parties may still ultimately end up filing a full notice after the declaration period at their election or the request of CFIUS. Declarations have been permitted since November 2018 for transactions subject to the pilot program, but once the new regulations take effect, they may be utilized for *any* transaction (investment or real estate) notified to CFIUS. Following its review of a declaration, CFIUS may take one of four actions: (1) request that the parties file a full written notice, (2) advise the parties that CFIUS cannot complete action based on the declaration and that the parties *may* submit a notice in order for CFIUS to complete action (commonly referred to as the "shrug"), (3) initiate a unilateral review of the transaction, or (4) notify the parties in writing that CFIUS has completed all action with respect to the transaction (i.e., cleared the transaction).

The ultimate usefulness of the declaration process is likely to depend on a combination of how willing CFIUS is to conclude action or give the shrug via declarations and parties' risk tolerance for accepting the shrug as a sufficient resolution absent conclusion of action. Although no statistics have been released in connection with the pilot program, indications were that relatively few transactions (somewhere between 10 and 20 percent) were cleared on the basis of a declaration, and the shrug was a more common outcome where CFIUS did not request a full notice. Of course, by definition the pilot program was targeted at transactions that were viewed as likely to be more sensitive from a national security perspective, so it is possible more transactions could be cleared with the broader use of declarations under the new regulations.

Other Key Points

- *New definition of principal place of business.* The regulations include a new definition for "principal place of business," which was a previously undefined element of the definition of "foreign entity." A foreign entity is defined as an entity organized under the laws of a foreign state if either its principal place of business is outside the United States or its equity securities are primarily traded on a foreign exchange. This can be an important jurisdictional distinction where entities are organized offshore for tax purposes, but effectively operate and are managed within the United States. "Principal place of business" is now defined as "the primary location where an entity's management directs, controls, or coordinates the entity's activities, or, in the case of an investment fund, where the fund's activities and investments are primarily directed, controlled, or coordinated by or on behalf of the general partner, managing member, or equivalent." That is qualified, however, by a provision stating that if in the most recent filing to a government agency (other than CFIUS) the entity's principal place of business is listed as being outside of the United States, then that foreign location shall be deemed the principal place of business. Essentially, this provision provides a practical standard of a principal place of business generally, but also seeks to avoid allowing parties to claim different principal places of business for different regulatory filings. As the definition of "principal place of business" is new in the final regulations, it is effective on February 13 as an interim rule, but subject to a 30-day public comment period and potential revision.

- *No filing fees – yet.* The regulations do not contain any provisions for filing fees, but the commentary notes that filing fees will be the subject of a separate rulemaking. FIRRMA authorizes CFIUS to impose filing fees not to exceed the lesser of one percent of the value of the transaction or $300,000 (adjusted for inflation).

- *Potentially expansive definition of "US business."* CFIUS's long-standing regulations defined "US business" to mean any entity engaged in interstate commerce in the United States, *but only to the extent of its activities in interstate commerce*. The definition in the new regulations deletes the limitation "*but only to the extent of its activities in interstate commerce.*" In response to public comments requesting clarity on how expansive CFIUS viewed the new definition, CFIUS states that the "definition tracks the language of FIRRMA and is not intended to suggest that the extent of a business's activities in interstate commerce in the United States is irrelevant to the

Committee's analysis of national security risk." The new regulations also added language to an example clarifying that a foreign entity that only has operations and personnel outside of the United States is not a US business by virtue of providing remote technical support services (along with exporting and licensing technology) to customers in the United States. While it is helpful that the regulations clarified that, from a jurisdictional standpoint, there must be some actual US operations for there to be a US business, the regulations did not clarify to what extent *non-US* operations would also be considered part of the "US business." CFIUS's deliberate silence on this point indicates that CFIUS is leaving itself flexibility about how broadly it may interpret (i) the scope of a "US business" in the context of any given transaction before it, and by extension, flexibility about how broadly it may interpret (ii) the "covered transaction" that is the subject of its review, (iii) the national security concerns that arise from such "covered transaction," and (iv) the extent of the mitigation or divestment actions that CFIUS or the President may take to resolve any such national security concerns.

- *"Incremental acquisition rule" is extended to declarations*. The new regulations have been revised to clarify that the long-standing "incremental acquisition rule" – i.e., a transaction will not be deemed a "covered transaction" if a foreign person acquires an additional interest in a US business over which the same foreign person (or any entity that it wholly owns, directly or indirectly) previously acquired direct control in a transaction for which CFIUS concluded action – applies in cases in which CFIUS concludes action in a covered control transaction on the basis of either a notice or a declaration. This change provides stronger safe harbor protection for parties whose control transactions are cleared via the declaration process. The incremental acquisition rule does not apply to covered investments or for control transactions in which, following an assessment of a declaration, CFIUS does not conclude action (even if no notice is requested).

- *Effectiveness of the new regulations.* The current regulations – including mandatory filing requirements under the pilot program – will remain in effect through February 12, 2020 and will apply to any transaction for which any of the following has occurred *prior* to February 13, 2020:

    - the completion date;
    - the parties to the transaction have executed a binding written agreement, or other binding document, establishing the material terms of the transaction;
    - a party has made a public offer to shareholders to buy shares of a US business; or
    - a shareholder has solicited proxies in connection with an election of the board of directors of a US business or an owner or holder of a contingent equity interest has requested the conversion of the contingent equity interest.

With respect to transactions subject to mandatory filing requirements under the new regulations, starting February 13, 2020, a declaration (or written notice in lieu of a declaration) must be submitted no later than (1) February 13, 2020, or promptly thereafter, if the completion date of the transaction is between February 13, 2020 and March 14, 2020; or (2) at least 30 days before the completion date of the transaction, if the completion date is after March 14, 2020.

The new regulations bring substantial changes to the CFIUS regime – most notably mandating certain filings for the first time and expanding CFIUS's jurisdiction beyond control deals and even to real estate transactions lacking a traditional investment in a business. That said, FIRRMA was designed to fill gaps that could potentially be exploited, and as such, much of the expansion of CFIUS's authority is tailored in a relatively narrow way. Most significantly, the jurisdictional expansion regarding investments and mandatory filing requirements are exclusively focused on TID US businesses, which CFIUS has clearly identified as presenting heightened national security vulnerabilities. There is no change to the jurisdiction rules with respect to foreign investments in non-TID US businesses. Similarly, the real estate regulations serve to provide CFIUS the authority to reach new transactions that may present close-proximity

concerns (a long-standing issue of interest to the committee) and highlight for transaction parties the specific geographical areas of sensitivity.

Importantly, whereas the jurisdictional assessment for investments in TID US businesses and real estate has become complex and in some cases highly technical under the new regulations, that is only one part of the analysis. The substantive risk assessment of any given transaction – regardless of whether it is subject to CFIUS's new authorities – remains a key issue for parties to consider during deal planning and negotiations.

Petitions and Investigations

US Department of Commerce Initiates Antidumping and Countervailing Duty Investigations of Wood Mouldings and Millwork Products from Brazil and China

On January 29, 2020, the US Department of Commerce (DOC) announced the initiation of antidumping duty (AD) investigations concerning imports of wood mouldings and millwork products from Brazil and China, and a countervailing duty (CVD) investigation concerning imports of the same products from China. These investigations were initiated based on petitions filed by the Coalition of American Millwork Producers, whose members are Bright Wood Corporation (Madras, OR), Cascade Wood Products, Inc. (White City, OR), Endura Products, Inc. (Colfax, NC), Sierra Pacific Industries (Red Bluff, CA), Sunset Moulding (Live Oak, CA), Woodgrain Millwork, Inc. (Fruitland, ID), and Yuba River Moulding (Yuba City, CA). The dumping margins alleged in the petitions are 86.73 percent for Brazil, and range between 181.17 and 359.16 percent for China. In addition, the petitions allege that the subject products from China benefit from countervailable subsidies including preferential lending programs, export credit programs, tax programs, indirect tax programs, grant programs, and the provision of inputs at less than adequate remuneration.

The products subject to these investigations consist of wood mouldings and millwork products that are made of wood (regardless of wood species), bamboo, laminated veneer lumber (LVL), or of wood and composite materials (where the composite materials make up less than 50 percent of the total merchandise), and which are continuously shaped wood that undergoes additional manufacturing or finger-jointed or edge-glued moulding or millwork blanks (whether or not resawn). Imports of wood mouldings and millwork products are primarily entered under the following Harmonized Tariff Schedule of the United States (HTSUS) numbers: 4409.10.4010, 4409.10.4090, 4409.10.4500, 4409.10.5000, 4409.22.4000, 4409.22.5000, 4409.29.4100, and 4409.29.5100. Imports of wood mouldings and millwork products may also enter under HTSUS numbers 4409.10.6000, 4409.10.6500, 4409.22.6000, 4409.22.6500, 4409.29.6100, 4409.29.6600, 4418.99.9095 and 4421.99.9780.

During DOC's investigations of the subject imports, the US International Trade Commission (ITC) is scheduled to conduct its own investigations into whether the US industry is being injured by such imports. The ITC will make its preliminary determinations on or before February 24, 2020. If the ITC preliminarily determines that there is a reasonable indication of material injury or threat of material injury, the DOC investigations will continue, with the preliminary CVD determination scheduled for April 2, 2020, and preliminary AD determinations scheduled for June 16, 2020, unless these deadlines are extended.

If DOC preliminarily determines that dumping and/or countervailable subsidization is occurring, then it will instruct US Customs and Border Protection to start collecting cash deposits from all US companies importing wood mouldings and millwork products from Brazil and/or China. Final determinations by DOC in these cases are scheduled for June 16, 2020 for the CVD investigation, and August 31, 2020 for the AD investigations, but these dates may be extended. If DOC finds that products are not being dumped or unfairly subsidized, or the ITC finds in its final determinations there is no injury to the US industry, then the investigations will be terminated, and no duties will be applied. If DOC makes affirmative findings in these investigations, and if the ITC determines that dumped and/or unfairly subsidized US imports of wood mouldings and millwork products from Brazil and/or China materially injure, or threaten material injury to, the US industry, DOC will impose duties on those imports in the amount of dumping and/or countervailable subsidization found to exist.

In 2018, imports of wood mouldings and millwork products from Brazil and China were valued at an estimated $291.8 million and $208.4 million, respectively.

US Department of Commerce Issues Final Determinations in Antidumping and Countervailing Duty Investigations of Fabricated Structural Steel from Canada, China, and Mexico

On January 24, 2020, the US Department of Commerce (DOC) announced its affirmative final determinations in the antidumping duty (AD) investigations of fabricated structural steel (FSS) from Canada, China, and Mexico. In addition, DOC announced affirmative final determinations in the countervailing duty (CVD) investigations concerning imports of FSS from China and Mexico, and a negative final determination in the CVD investigation concerning imports of the same products from Canada.

In its investigations, DOC determined that producers and/or exporters from Canada, China, and Mexico have sold FSS at less than fair value in the United States at rates of 0-6.70 percent (Canada), 61.71-154.14 percent (China), and 0-30.58 percent (Mexico). In addition, DOC determined that producers and/or exporters from China and Mexico received countervailable subsidies at rates of 27.34-206.49 percent (China) and 0.01-68.87 percent (Mexico). Because DOC reached a negative CVD determination with respect to producers and/or exporters from Canada, the CVD investigation with respect to Canada is terminated and no countervailing duties will be collected on imports from Canada.

The petitioner in this investigation is the American Institute of Steel Construction Full Member Subgroup (Chicago, IL). The merchandise covered by the investigation is carbon and alloy fabricated structural steel. Fabricated structural steel is made from steel in which: (1) iron predominates, by weight, over each of the other contained elements; and (2) the carbon content is two percent or less by weight. The products subject to the investigation are currently classified in the Harmonized Tariff Schedule of the United States (HTSUS) under subheadings: 7308.90.3000, 7308.90.6000, and 7308.90.9590. The products subject to the investigation may also enter under the following HTSUS subheadings: 7216.91.0010, 7216.91.0090, 7216.99.0010, 7216.99.0090, 7222.40.6000, 7228.70.6000, 7301.10.0000, 7301.20.1000, 7301.20.5000, 7308.40.0000, 7308.90.9530, and 9406.90.0030.

The US International Trade Commission (ITC) is currently scheduled to make its final injury determinations on or around March 9, 2020. If the ITC makes affirmative final injury determinations, DOC will issue AD and CVD orders. If the ITC makes negative final determinations of injury, the investigations will be terminated, and no orders will be issued.

In 2018, imports of FSS from Canada, China, and Mexico were valued at an estimated $722.5 million, $897.5 million, and $622.4 million, respectively.

US Department of Commerce Initiates Antidumping and Countervailing Duty Investigations of Imports of Forged Steel Fluid End Blocks from China, Germany, India, and Italy

On January 9, 2020, the US Department of Commerce (DOC) announced the initiation of new antidumping duty (AD) investigations concerning imports of forged steel fluid end blocks from Germany, India, and Italy. In addition, DOC initiated countervailing duty (CVD) investigations concerning imports of the same products from China, Germany, India, and Italy. These investigations were initiated based on petitions filed by the FEB Fair Trade Coalition (Cleveland, OH); Ellwood City Forge Company, Ellwood Quality Steels Company, and Ellwood National Steel Company (Ellwood City, PA); and A. Finkl & Sons (Chicago, IL). The dumping margins alleged in the petitions are 83.37 percent for Germany, 198.85 percent for India, and 87.04 percent for Italy. There are 24 subsidy programs alleged for China, 16 subsidy programs alleged for Germany, 29 subsidy programs alleged for India, and 20 subsidy programs alleged for Italy.

The products subject to these investigations are forged steel fluid end blocks (fluid end blocks), whether in finished or unfinished form, and which are typically used in the manufacture or service of hydraulic pumps. The term “forged” is

an industry term used to describe the grain texture of steel resulting from the application of localized compressive force. The products included in the scope of these investigations may enter under Harmonized Tariff Schedule of the United States (HTSUS) subheadings 7218.91.0030, 7218.99.0030, 7224.90.0015, 7224.90.0045, 7326.19.0010, 7326.90.8688, or 8413.91.9055.

DOC is scheduled to make its preliminary CVD determinations by March 13, 2020, and its preliminary AD determinations by May 27, 2020, unless these deadlines are extended. If DOC preliminarily determines that dumping and/or unfair subsidization is occurring, it will instruct US Customs and Border Protection to start collecting cash deposits from all US companies importing forged steel fluid end blocks from China, Germany, India, and Italy.

Final determinations by DOC in these cases are scheduled for May 27, 2020, for the CVD investigations, and August 10, 2020, for the AD investigations, but these dates may be extended. If DOC finds that products are not being dumped or subsidized, or the US International Trade Commission (ITC) finds in its final determinations that there is no injury to the US industry, the investigations will be terminated and no duties will be applied. If DOC makes affirmative findings in these investigations, and if the ITC determines that dumped and/or subsidized US imports of forged steel fluid end blocks from China, Germany, India, and Italy are causing injury to the US industry, DOC will impose duties on those imports in the amount of dumping and/or countervailable subsidization found to exist.

The petitioners estimated that imports of forged steel fluid end blocks China, Germany, India, and Italy were valued at approximately $17.8 million, $23.3 million, $44.4 million, and $46.4 million, respectively, in 2018.

US Department of Commerce Issues Affirmative Preliminary Antidumping Duty Determination on Collated Steel Staples from China

On January 3, 2020, the US Department of Commerce (DOC) announced its affirmative preliminary determination in the antidumping duty (AD) investigation of imports of collated steel staples from China. In its investigation, DOC preliminarily determined that exporters from China have sold collated steel staples in the United States at a dumping margin of 301.64 percent. As a result of the determination, US Customs and Border Protection will collect cash deposits from importers of collated steel staples from China based on this preliminary rate.

The petitioner in this investigation is Kyocera Senco Industrial Tools, Inc. (Cincinnati, OH). The products subject to the investigation are certain collated steel staples, made from steel wire having a nominal diameter from 0.0355 inch to 0.0830 inch, inclusive, and have a nominal leg length from 0.25 inch to 3.0 inches, inclusive, and a nominal crown width from 0.187 inch to 1.125 inch, inclusive. Certain collated steel staples may be manufactured from any type of steel and are included in the scope of the investigations regardless of whether they are uncoated or coated, and regardless of the type or number of coatings, including but not limited to coatings to inhibit corrosion. Certain collated steel staples subject to these investigations are currently classifiable under subheading 8305.20.00.00 of the Harmonized Tariff Schedule of the United States (HTSUS).

DOC is scheduled to announce its final determination on or around May 19, 2020. If DOC's final determination is affirmative, the US International Trade Commission (ITC) will be scheduled to make its final injury determination on or around July 2, 2020. If DOC makes an affirmative final determination of dumping, and the ITC makes an affirmative final injury determination, DOC will issue an AD order. If DOC makes a negative final determination of dumping, or the ITC makes a negative final determination of injury, the investigation will be terminated and no order will be issued.

In 2018, imports of collated steel staples from China were valued at an estimated $88.8 million.

US Department of Commerce Initiates Antidumping Duty Investigation of Imports of 4th Tier Cigarettes from Korea

On January 8, 2020, the US Department of Commerce (DOC) announced the initiation of an antidumping duty (AD) investigation concerning imports of 4th tier cigarettes from Korea. The petitioner in this investigation is the Coalition Against Korean Cigarettes, whose members are Xcaliber International (Pryor, OK) and Cheyenne International (Grover, NC). The dumping margins alleged in the petition range from 7.10 to 113.06 percent.

The products subject to the investigation are certain tobacco cigarettes, commonly referred to as "4th tier cigarettes." The subject cigarettes are composed of a tobacco blend rolled in paper, have a nominal minimum total length of 7.0 cm but do not exceed 12.0 cm in total nominal length, and have a nominal diameter of less than 1.3 cm. Merchandise covered by this investigation is currently classified in the Harmonized Tariff Schedule of the United States (HTSUS) under subheading 2402.20.8000.

DOC is scheduled to announce its preliminary determination in this investigation by May 27, 2020, although this date may be extended. If DOC preliminarily determines that dumping is occurring, it will instruct US Customs and Border Protection to start collecting cash deposits from all U.S. companies importing 4th tier cigarettes from Korea. DOC's final determination in this case is scheduled for August 10, 2020, but this date may be extended. If DOC finds that products are not being dumped, or the US International Trade Commission (ITC) finds in its final determination that there is no harm to the US industry, the investigation will be terminated and no duties will be applied. If DOC makes an affirmative finding in this investigation, and if the ITC determines that dumped imports of 4th tier cigarettes from Korea are causing injury to the US industry, DOC will impose duties on those imports in the amount of dumping found to exist.

US International Trade Commission Issues Affirmative Final Determination in Antidumping Investigation of Carbon and Alloy Steel Threaded Rod from Taiwan

On January 10, 2020, the US International Trade Commission (ITC) determined that a US industry is materially injured by reason of imports of carbon and alloy steel threaded rod from Taiwan. The US Department of Commerce (DOC) determined in December 2019 that imports of this product from Taiwan were sold in the United States at dumping margins of 32.26 percent. As a result of these determinations, DOC will issue an antidumping duty order on imports of this product from Taiwan.

The merchandise covered by these investigations is carbon and alloy steel threaded rod. Steel threaded rod is certain threaded rod, bar, or studs of carbon or alloy steel, having a solid, circular cross section of any diameter, in any straight length. Steel threaded rod is currently classifiable under subheadings 7318.15.5051, 7318.15.5056, and 7318.15.5090 of the Harmonized Tariff Schedule of the United States (HTSUS). Subject merchandise may also enter under subheading 7318.15.2095 and 7318.19.0000 of the HTSUS.

In 2018, imports of carbon and alloy steel threaded rod from Taiwan were valued at an estimated $156 million.

US International Trade Commission Issues Negative Final Determinations in Antidumping and Countervailing Duty Investigations of Dried Tart Cherries from Turkey

On January 14, 2020, the US International Trade Commission (ITC) determined that a US industry is not materially injured or threatened with material injury by reason of imports of dried tart cherries from Turkey. The US Department of Commerce (DOC) had determined in December 2019 that imports of this product from Turkey are sold in the United States at dumping margins ranging from 541.29 percent to 648.35 percent and received countervailable subsidies at a rate of 204.93 percent. However, as a result of the USITC's negative determinations, no antidumping and countervailing duty orders will be issued.

Chairman David S. Johanson and Commissioners Rhonda K. Schmidtlein, Jason E. Kearns, Randolph J. Stayin, and Amy A. Karpel voted in the negative. The ITC's public report on the investigation will be made available by February 18, 2020, and will contain the views of the Commission and information developed during the investigations.

US Department of Commerce Issues Affirmative Preliminary Circumvention Ruling on Exports of Hydrofluorocarbon Blends from China

On January 23, 2020, the US Department of Commerce (DOC) announced an affirmative preliminary antidumping duty (AD) circumvention ruling involving imports of unfinished R-32/R-125 of hydrofluorocarbons (HFCs) from China that are further processed in the United States. In its investigation, DOC preliminarily determined that imports of these products are circumventing the existing AD order on imports of HFC blends (R–404A, R-407A, R–407C, R–410A, and R–507A) from China.

As a result of these determinations, DOC will instruct US Customs and Border Protection (CBP) to collect AD cash deposits on imports of unfinished blends of HFC components R-32 and R-125 from China. The applicable cash deposit rate will be equal to the rates previously established and in effect at the time of entry. Suspension will apply to any future imports and unliquidated entries since June 18, 2019 (the date on which Commerce initiated the circumvention inquiry). DOC expects to issue its final ruling in this investigation by April 7, 2020.