Navigating Rules of Origin in the New Trade Environment
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Section 301 (Chapter 1 of Title III of the Trade Act of 1974, codified as amended in 19 U.S.C. §§ 2411-2417) allows the U.S. Trade Representative ("USTR") to impose trade restrictions if the practice of a foreign country denies benefits to the United States under a trade agreement or restricts U.S. commerce. After USTR initiated a section 301 investigation in 2017 regarding China's practices related to forced technology transfer, unfair licensing, and intellectual property rights, the President instructed USTR to publish proposed lists of products of China subject to additional U.S. tariffs. Lists 1, 2, 3, 4A and 4B are enumerated in Chapter 99, Harmonized Tariff Schedule of the United States (HTSUS).[2]

A product of China is considered any imported article that is wholly the growth, product or manufacture of China. Going back to 1908, the Supreme Court in *Anheuser Busch Brewing Ass'n v. United States*, 207 U.S. 556 (1908), found that in order for an article to be the growth, product or manufacture of a country, it must undergo processes that result in a transformation such that "a new and different article must emerge, having a distinctive name, character, or use." *Id.* at 562. Therefore, for purposes of making section 301 determinations when an article is not wholly the growth of China, U.S. Customs and Border Protection (CBP) applies the substantial transformation test.

Navigating the rules of origin in this new section 301 trade environment has importers questioning CBP's use of the substantial transformation test, especially when that trade involves imports from Canada and Mexico. Further, importers have alleged that CBP has recently changed the way it is applying the substantial transformation test in light of section 301. Now more than ever, CBP needs guidance from the courts to navigate the fluid supply chain.

Importers' questioning CBP's use of the substantial transformation test for purposes of section 301 is not the first time the use of substantial transformation has been challenged. In *Ferrostaal Metals Corp. v. United States*, 11 C.I.T. 470, 473, 664 F. Supp. 535, 537 (1987), the CIT decided the substantial transformation test was appropriate for purposes of Voluntary Restraint Agreements, and noted the importance of the substantial transformation concept:

> Substantial transformation is a concept of major importance in administering the customs and trade laws. In addition to its role in identifying the country of origin of imported merchandise for purposes of determining dutiable status, or, as in this case, the applicability of a bilateral trade agreement [Voluntary Restraint Agreement], substantial transformation is the focus of many cases involving country of origin markings, *see, e.g.,*

[1] This paper is submitted for CLE purposes only, and does not necessarily reflect the views of U.S. Customs & Border Protection.

[2] Effective July 6, 2018, USTR imposed an additional 25 percent on imports of Chinese origin classified under the HTSUS subheadings included on List 1. Effective August 23, 2018, USTR imposed an additional 25 percent on Chinese origin products under the HTSUS subheadings included on List 2. Effective September 24, 2018, USTR imposed additional tariffs (initially 10 percent; as of June 2019 raised to 25 percent) on Chinese origin products under the HTSUS subheadings included on List 3. In addition, USTR imposed 15 percent duties on Chinese imports under the HTSUS subheadings included on List 4A (effective from September 1, 2019) and List 4B (effective from December 15, 2019).

National Juice Products Ass'n v. *United States*, 10 C.I.T. 48, 628 F. Supp. 978 (1986), and cases involving American goods returned, *see, e.g., Upjohn Co.* v. *United States*, 9 C.I.T. 600, 623 F. Supp. 1281 (1985).

See also Superior Wire v. United States, 867 F.2d 1409 (Fed. Cir. 1989) (using the substantial transformation test for purposes of a Voluntary Restraint Agreement).

Although the "name, character, or use" test for substantial transformation has its roots in the Supreme Court *Anheuser Busch* drawback decision on beer bottle corks, today, the substantial transformation standard applies to all of the following: "product of" determinations for the various free trade agreements (other than the North American Free Trade Agreement (NAFTA)), country of origin determinations for marking (19 U.S.C. § 1304) other than marking for goods under the NAFTA, country of origin determinations for government procurement, the double substantial transformation standard set forth in the Generalized System of Preferences and similar preferential tariff programs, and trade remedies. Therefore, for purposes of section 301, the traditional substantial transformation test is applied.

It has been argued that when components of Chinese origin are imported into Mexico or Canada to be made into a finished product, the NAFTA Marking Rules in 19 C.F.R. Part 102 should be used to determine the "country of origin." However, as set forth in 19 CFR 102.0, the 102 rules are only to be used for determining the country of origin of imported goods for the purposes specified in paragraph 1 of Annex 311 of the NAFTA. These specific purposes are: country of origin marking, determining the rate of duty and staging category applicable to originating textile and apparel products as set out in Section 2 (Tariff Elimination) of Annex 300-B (Textile and Apparel Goods), and determining the rate of duty and staging category applicable to an originating good as set out in Annex 302.2 (Tariff Elimination). 19 CFR 102.0. As such, although the NAFTA Marking Rules are generally intended to reflect the substantial transformation test (*see* T.D. 94-4, 59 Fed. Reg. 110, Jan. 3, 1994), where production processes of a good are split amongst several countries, the required section 102.11 hierarchy in determining the "country of origin" for marking purposes may not always lead to the same result obtained by applying the substantial transformation analysis.[3] This is not necessarily a flaw, as the ultimate purpose of the NAFTA Marking Rules is not the same as the remedies sought under section 301. Further, as stated above for free trade agreements, other than NAFTA, the normal substantial transformation analysis applies for determining whether the good is a "product of" a country, and the additional tariff rules for that particular free trade agreement only apply for preferential tariff purposes.

Ultimately, if the outcome of an origin determination under section 301 is that the article is a product of China, especially when the NAFTA Marking Rules lead to a different result, importers may argue that CBP has changed the way it is applying the substantial transformation test. In making its origin determinations, CBP always reads the latest court decision that

[3] An example is that of subassemblies of Chinese origin imported into Mexico where they were assembled into an electric motor. Since the subassemblies met the tariff shift requirement under 19 C.F.R. § 102.11(a)(3), the country of origin for marking purposes was Mexico. As the assembly of the subassemblies into a motor in Mexico did not result in a substantial transformation of the Chinese parts, the motor remained a product of China for purposes of the application of Chapter 99, HTSUS. *See* HQ H301619, dated Nov. 6, 2018.

discusses substantial transformation with interest, and that case was *Energizer Battery, Inc. v. United States*, 190 F. Supp. 3d 1308 (Ct. Int'l Trade 2016) ("*Energizer*"). In *Energizer*, the court examined the origin of an LED flashlight made up of approximately 50 different components for the purposes of government procurement under The Trade Agreements Act of 1979. Assembled in the United States, the finished flashlight contained five LEDs in white, red, green, blue, and infrared. Other than a white LED light and a hydrogen getter, all of the flashlight's components were manufactured in China. Applying the name, character, and use test, the court also provided a historical overview of substantial transformation's application.

Pertaining to the "name" prong, the court in *Energizer* only noted it briefly and remarked that courts rely more heavily upon character and use. *Id.* at 1318; *see also Nat'l Juice Prods.*, 10 C.I.T. 48, 59 (a country of origin marking case in which the court noted that "a change in the name of the product is the weakest evidence of a substantial transformation.")

With regard to "character," *Energizer* defined the term and observed that the courts have found a requirement for a substantial alteration in the characteristics of the article or components, citing to *National Hand Tool Corp. v. United States, 16 C.I.T. 308 (1992),* and that a cosmetic change is insufficient, citing to *Superior Wire. Id.* Likewise, the court noted that CBP's repeated reference to "essential character" is not an established factor in the substantial transformation analysis, although *Energizer* recognized that some courts have looked to the "essence" of a finished article. *Id.* at 1315, 1316. Some of the decisions *Energizer* cited included:

- *Uniden America Corp. v. United States*, 24 C.I.T. 1191 (2000), a Generalized System of Preferences case in which a cordless telephone consisted of 275 parts sourced in the Philippines and third-countries and an A/C adapter imported pre-assembled in China. In its examination of *Uniden*, *Energizer* noted that "essential character" is used for classification purposes, yet it did repeat *Uniden's* finding that the A/C adapter did not impart the essential character of the cordless telephone and thus, did not undermine the conclusion that the cordless telephon's other imported parts, once assembled together, had undergone a substantial transformation and were a product of a beneficiary developing country ("BDC").
- *Uniroyal, Inc. v. United States*, 3 C.I.T. 220 (1982), a country of origin marking case, where a shoe upper from Indonesia with the ultimate shape, form, and size of the finished shoe was determined to be "the very essence of the finished shoe," and that stitching the upper to the pre-shaped outer sole in the United States did not constitute a substantial transformation. *Id.* at 224.

With regard to changes in "use," the court in *Energizer* stated that a change occurred when the end-use of the *imported product* was no longer interchangeable with the *product after post-importation processing*. *Id*. at 1319 (*emphasis added*). For support, the court cited to various decisions including:

- *Ferrostaal Metals Corp. v. United States*, 11 C.I.T. 470, 477, 664 F. Supp. at 540 (1987), where the court determined that a change in character occurred when a "continuous hot-dip galvanizing process transforms a strong, brittle product which

cannot be formed into a durable, corrosion-resistant product which is less hard, but formable for a range of commercial applications."

- *National Hand Tool Corp. v. United States*, 16 C.I.T. 308 (1992), where the court found no change in origin of hand tools forged into their final shape in Taiwan and imported into the United States for further processing. Although the court in *Nat'l Hand Tool* stated that a pre-determined use would not preclude the finding of a substantial transformation, and the determination must be based on the totality of the evidence, *Energizer*'s take away was that courts have generally not found a pre-determined end use to be a change in use.
- *Uniroyal*, 3 C.I.T. at 226, 542 F. Supp. at 1031, where the court did not find substantial transformation when the imported upper underwent no physical change, "[n]or was its intended use changed. The upper was manufactured by plaintiff in Indonesia to be attached to an outsole; it was imported and sold to Stride-Rite for that purpose; and Stride-Rite did no more than complete the contemplated process."

Finally, the court in *Energizer* noted that prior decisions considered the nature of the assembly together with the three-prong substantial transformation test. *Id* at 1320. The court cited:

- *Belcrest Linens v. United States*, 741 F.2d 1368 (Fed. Cir. 1984), in which the Federal Circuit considered stenciled, marked, and embroidered bolts of cloth from China shipped to Hong Kong where they were cut into individual pieces, scalloped, folded, sewn, pressed and packaged as finished pillowcases. The court found a substantial transformation based on "the extent of the operations performed and whether the parts lose their identity and become an integral part of a new article." *Belcrest Linens*, 741 F.2d at 1373.
- *Nat'l Hand Tool*, where the court noted that when assembly operations were manual and required some "skill and dexterity to put components together with a screw driver," but the names, form and character of each component remained unchanged, and the use of the imported articles was pre-determined, no substantial transformation had occurred. *Nat'l Hand Tool*, 16 C.I.T. at 310-313.

The court also noted that prior decisions compared the degree of operations performed pre-importation versus post-importation to evaluate whether a substantial transformation occurred. Citing *Nat'l Hand Tool* again, *Energizer* acknowledged that the pre-importation processing of cold forming and hot-forging required more complicated functions than post-importation processing, which included heat treatment and electroplating.

Focusing first on character, *Energizer* found the assembly operation in the United States did not constitute a substantial transformation. The post-importation assembly operations of the flashlight's components did not result in a change in the shape or material composition of any imported component. *Energizer*, 190 F. Supp. 3d at 1322. Finding no change in name, and stating that although it was not bound by *Nat'l Hand Tool*, *Energizer* concluded that this was exactly the same situation which arose in *Nat'l Hand Tool*, 16 C.I.T. at 311, where "[f]or instance, a lug, called a 'G-head' at the time of importation, was still called a 'G-head' even after it was assembled into a completed flex handle." Regarding use, *Energizer* highlighted the pre-determined end use of the imported components and how they were partially pre-assembled.

Interestingly, while CBP discussed the programming of the flashlights in its final determination, the court makes no mention of programming the flashlights, other than to CBP's recitation of the facts that it occurred.

After considering the latest decision pertaining to the substantial transformation test, it becomes apparent that there is little dispute over a change in name. The court criticizes CBP's use of "essential character," although at least four prior court decisions have either used that term or acknowledged CBP's proper application of the "essential character" analysis. *See Nat'l Juice Prods*, 10 C.I.T. 48, 61; *CPC Int'l v. United States,* 21 C.I.T. 784 (1997); *Uniden*, 24 C.I.T. 1191; and *Coastal States Marketing, Inc. v. United States*, 10 C.I.T. 613, 617, 646 F. Supp. 255, 259 (1986). As it stated regarding *Nat'l Hand Tool*, perhaps the court did not consider itself bound by those decisions either because of *de novo* review, or because it agrees with CBP that the substantial transformation analysis is conducted case-by-case, noting that the courts generally agree that each case must be decided on its facts. Regarding what can be interpreted as an intersection between a pre-determined end use and assembly, perhaps *Energizer* is signaling that the production processes of today may not reflect those of the past, and that a complex and meaningful assembly now has a higher bar.

One thing is certain that according to the court, CBP may not have articulated the test with clarity, but *Energizer* did agree with CBP's decision. CBP's final determination and *Energizer* were also decided before section 301 remedies became effective, so if CBP has allegedly scrutinized certain assembly processes more strictly, it is not in response to section 301. However, in considering all of the prior court cases mentioned, *Energizer* missed the opportunity to discuss newer technologies such as programming and the installation of software which were considered in CBP's final determination and which have not been evaluated since 1982 in *Data General v. United States*, 4 C.I.T. 182 (1982). CBP still continues to analyze the impact of programming on the origin of an article. However, the decision in *Energizer* does not necessarily instill comfort on relying on the court's prior decisions. Therefore, as importers have sought more country of origin decisions this year in an attempt to shift their complex and meaningful assembly processes to avoid paying the additional duties, the line to be drawn still remains less than unclear.

The headquarters and New York offices of CBP have worked together to issue many rulings in 2019 on origin to provide some business certainty. Often the ruling requests involve multiple factual scenarios, which perhaps in the ordinary course of trade would not necessarily be contemplated. For example, in NY N304889, dated July 19, 2019, crabs were caught on the coast of China, where the crab's carapace, claws and gills were removed. In Vietnam, the crabs were cooked and the meat was picked, being packed in either cans or pouches. Similarly, in NY N305683, dated September 6, 2019, the carapace and digestive organs were removed and the crabs were frozen prior to exportation to Vietnam where they were cooked, and the meat was picked and later packed in cans. In both cases, CBP found that because the crabs were already disassembled in China and did not present as an entire crab when they were shipped to Vietnam, the processing in Vietnam was not a substantial transformation. Although it could be argued that *Koru North America v. United States*, 12 C.I.T. 1120, 701 F. Supp. 229 (CIT 1988), should have provided the result where the fileting of a fish in one area was a substantial transformation, it was CBP's view that cracking a crab in multiple countries does not result in a different product

because the meat is lastly picked in a second country, which follows CBP's consistent and long-standing application of *Nat'l Juice Prods*.

In the context of assembly concerning vacuum cleaners, in NY N303710, dated April 26, 2019, CBP considered the origin of upright, electric-powered vacuum cleaners, packaged with accessories (*i.e*. handle, dusting brush, upholstery tool, crevice tool, etc.). The vacuums were made from over 30 components and sub-assemblies sourced from China and Vietnam, with final assembly in Vietnam. Approximately 30 percent of the listed components and sub-assemblies, such as brushes, pedals, crevice tubs, motor assembly, power cords and switches, were imported from China. In making the decision that the origin was Vietnam, CBP noted that the production of the vacuum cleaners in Vietnam consisted both of the manufacture of several of the product's key sub-assemblies, including the dust cup, brush, and body sub-assemblies, and the vacuum's final assembly took place in Vietnam. Arguably, based on *Energizer*, CBP could have found no substantial transformation based on the fact that the motor assembly was made in China and it had a predetermined use of providing suction to the vacuum cleaner. Nonetheless, perhaps taking into account that more components were actually made in Vietnam (compared to the situation of the U.S. components in *Energizer)*, or that the overall post-importation processing in Vietnam was at least comparable to the pre-importation processing in China, along with the fact that final assembly took place in Vietnam, one may conclude that the correct country of origin should be Vietnam. In any event, it seems that CBP's long-standing articulation of a complex and meaningful assembly in C.S.D. 85-25, 19 Cust. Bull. 844 (1985) (HRL 071827 dated September 25, 1984), still remains in effect.

Lastly, another scenario that CBP recently examined involved Chinese raw steel shipped to Vietnam for forging into the shape of pliers and later returned to China for hole drilling, teeth milling, assembly, and other polishing processes. In examining the court's prior decisions, CBP decided to find that the forging process in Vietnam was more important per *Nat'l Hand Tool*, than the machining processes considered important in *Midwood Industries, Inc. v. United States,* 64 Cust. Ct. 499, C.D. 4026, 313 F.Supp. 951 (1970), even though the raw steel also originated in China. Hence, navigating the rules of origin in this changing environment remains in flux. The solution may be a more strict application of the substantial transformation test, to the pre-NAFTA days where many articles often were marked with more than one country of origin to enable the ultimate purchaser to know where the goods were produced, if such marking should influence his will. The implications of such a change, especially in the context of section 301, is a topic for another day.