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The Evolution of TAA Compliance Post-Energizer – "Substantially Transformed" Has Substantially Changed

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Trade Agreements Act compliance changed fundamentally three years ago. Or, so we thought on December 7, 2016, when the U.S. Court of International Trade ("CIT"), the appellate body for country of origin determinations issued by the U.S. Customs and Border Patrol ("CBP"), for the first time analyzed the meaning of "substantial transformation" under the Trade Agreements Act.("TAA").[i] To celebrate this third anniversary, we reviewed the CBP decisions issued over the last three years: (1) to see if we were correct, (2) to determine exactly how the CIT decision fundamentally changed the substantial transformation analysis, and (3) to figure out how companies can best comply with the TAA after this landmark decision.

Where We Started: Energizer

In *Energizer Battery, Inc. v. United States*,[ii] plaintiff appealed a CBP decision finding a military flashlight to be of Chinese origin under the TAA. In so holding, CBP followed its longstanding "essential character" substantial transformation analytical framework. CBP determined the flashlight's Chinese LED gave the end product its "essential character," and, combined with the fact that the assembly process in the United States was not overly complex, the CBP held the flashlight end product was not substantially transformed in the United States.[iii]

Embracing this first opportunity to opine on the meaning of substantial transformation, on appeal, the CIT decision noted the vast CBP precedent on point, but ultimately granted those decisions little-to-no weight. In determining the meaning of substantial transformation, the CIT heavily relied on the language of the TAA and implementing regulations, which require "a new and different article of commerce with a name, character, or use distinct from that of the article or articles from which it was transformed." In doing so, the CIT minimized the importance of the "essential character" test relied upon by CBP, noting it "is not an established factor in the substantial transformation analysis," while nonetheless remaining open to the idea that the country of origin for a component that is the "essence" of an end product could be dispositive in a country of origin determination. The CIT also left the door open for use of additional "subsidiary factors" in this analysis, though provided little

guidance on how such factors should impact future CBP decisions.

Ultimately, in affirming China as the country of origin for the Energizer flashlight, the CIT relied on three main considerations:

First, the flashlight did not undergo a change in name, character, or use as a result of the post importation processing in the United States. Clearly the most important part of the court's analysis, the CIT reasoned all the imported components retained their individual names and material composition or shape as a result of the post-importation assembly process. Further, with regards to use, the CIT noted "when the end-use was pre-determined at the time of importation, courts have generally not found a change in use." This analytical framework was a conceptual departure from prior CBP precedent, which historically had analyzed whether the final end-product – not the individual *components* – underwent a change in name, character, or use.

Second, while explicitly noting this was of secondary consideration, the CIT held the assembly process in the United States was not sufficiently complex or meaningful to constitute a substantial transformation because the assembly primarily consisted of fastening the imported components together through a process that took between seven and twelve minutes. Put simply, the manufacturing process in the United States simply was not "substantial" enough to contribute to a "substantial transformation."

Third, the CIT concluded a product consisting of approximately 50 different components (all but 2 of which were Chinese origin) was a product of China when the U.S.-based assembly and integration process did not result in a substantial transformation. Interestingly, while the CIT in *Energizer* spent a significant amount of time on the "substantial transformation" analysis, the court spent very little time in comparison on the actual country of origin analysis, ultimately concluding the number of Chinse origin components necessitated China as the country of origin without meaningful analysis.

Even though the CIT maintained every analysis is fact specific and needs to be determined on an individual basis, and did not outright prohibit the use of other "subsidiary factors" historically used by CBP, the CIT's *Energizer* opinion appeared to set a higher bar for substantial transformation, meaning companies would seem to be required to do more in the U.S. than was previously the case before 2016 for TAA compliance.

Where We Are Today: Post-Energizer Analysis by the Numbers

While it is true substantial transformation appears to be more of an uphill battle than ever before, CBP still is relying heavily upon those "subsidiary factors" that were disfavored in *Energizer*.

Of the 53 publicly available CBP opinions we identified since December 2016 that rely, at least in part, on the CIT's decision in *Energizer*, only ***sixteen*** ultimately determined the country of origin for the end product in question was the United States or a Designated Country (*i.e.*, in roughly 70% of decisions CBP held the product in question was **not** TAA compliant.).

Further, only ***seven*** of these decisions ruled the end-product in question was *substantially transformed* in the United States or a Designated Country, [iv] with the other decisions defaulting to the country of origin of an essential part or components of the end product. And only ***one*** of these decisions found that substantial transformation occurred *in the United States*, [v] with the other decisions concluding that substantial transformation occurred internationally. Thus, just as we thought, the published decisions bear out that proving substantial transformation in a post-*Energizer* world is no easy feat.

As can be seen from these statistics, but perhaps even more notably, these CBP decisions identified a vital flaw in the *Energizer* opinion. That is, while the CIT in *Energizer* provided detailed analysis on the "substantial transformation" and "name, character, and use" tests, the CIT failed to provide CBP any guidance on what to do when they find the end product was not substantially transformed in any one country. In such situations, CBP is still required to make a country of origin determination. It is in this vein that CBP has continued to rely on a "totality of circumstances" analysis, utilizing the very "subsidiary factors" that were generally disfavored, though not strictly prohibited, in the *Energizer* opinion.[vi]

Our analysis revealed:

- Roughly half of the opinions analyzed, at least in part, whether the post-importation assembly processes were sufficiently complex to constitute substantial transformation. However, of these only ***four*** decisions found the post-importation assembly processes were sufficiently complex to qualify as substantial transformation. In each of those four decisions, the post-importation assembly process was quite complex, including

numerous processes and/or taking multiple hours, or even days, to complete.[vii]

- An end-product's "essence" or "essential character" was analyzed in at least ***twenty three*** CBP decisions, with at least ***sixteen*** decisions basing the ultimate country of origin decision for the end product on the determined origin of the product's "essence." *See, e.g.*, *The Classification and Country of Origin of Touchscreen Controllers from Taiwan*, NY N302701 (Mar. 15, 2019) (finding the "country of origin of the touchscreen display controller is based on the overlay, which is the component that gives the assembly its essential character.").[viii]

- On at least ***eight*** occasions, CBP considered from where the majority of an end-product's components originated, more in line with the CIT's decision in *Energizer*, which recognized the number of parts from China in its analysis. *See, e.g.*, *U.S. Government Procurement; Country of Origin of Insufflation Tubing*, HQ H298148 (Jun. 20, 2018) (finding because all of the components were from China and none of the components were substantially transformed, the country of origin was China).[ix]

- Although historically CBP has taken into consideration the cost of component parts, this trend appears to be faltering, as only one decision considered costs of component parts, and no decision based a country of origin determination on this factor alone***.[x]***

What Does This All Mean?

In sum, the CIT's decision in *Energizer* clearly has impacted how CBP analyzes substantial transformation under the TAA. Interestingly, although the CIT's decision fundamentally altered this analysis, the lack of clear guidance as to how to determine the country of origin when an end product was not substantially transformed in any one country frequently has left CBP to its own devices. In that vacuum, the vast majority of CBP decisions have focused on analysis of the "subsidiary factors," sticking to a "totality of circumstances" approach frequently utilized pre-*Energizer*. Thus, while, not surprisingly, the substantial transformation test post-*Energizer* has created a higher bar, the fact remains that most CBP decisions primarily are sticking to what they know.

Manufacturers would be wise to reevaluate their internal TAA substantial transformation analyses and their TAA countries of origin to ensure that the TAA analyses consider whether imported components retain their individual names and material composition or shape as a result of the post-importation assembly process. If not, these substantial transformation analyses should focus on the factors CBP's post-*Energizer* decisions show they value most: (1) whether the post-importation assembly process is complex *enough*, (2) the country of origin of the components that give the end product its essence, and (3) the country of origin of the majority of component parts.

[i] 19 U.S.C. §§ 2501-2582 and 48 C.F.R. Subpart 25.4.

[ii] 190 F.Supp.3d 1308, 38 Int'l Trade Rep. (BNA) 2029 (Dec. 7, 2016).

[iii] *See Notice of Issuance of Final Determination Concerning Generation II Military Flashlights*, 78 Fed. Reg. 26,058.

[iv] *See*, *Country of Origin of Certain Wearable Electronic Smart Devices; Substantial Transformation*, HQ H302801 (Oct. 3, 2019) (finding the "SMT operations [in Taiwan, Malaysia, or Indonesia] result in a new and different product with an overall use and function different than any one function of the individual components"); *The Country of Origin of Linear Actuators*, NY N305467 (Aug. 8, 2019) (finding the "assembly process performed in Taiwan results in a substantial transformation of the individual components into a new and different article of commerce with a name, character, and use distinct from the components used in the production of the motor actuators."); *The Country of Origin of the Contactless Reader Module from Taiwan*, NY N304425 (Jun. 12, 2019) (finding the manufacturing processes in Taiwan "constitutes substantial transformation of the original articles into a new or different article of commerce," therefore the Country of Origin of the Reader Modules was Taiwan); *The Country of Origin Determination of a Temperature Sensor from Mexico*, NY N301952 (Apr. 1, 2019) (finding the manufacturing processes in Mexico "substantially transform the various components into the temperature sensor of Mexican origin."); *The Application of Section 301 Remedies for Electronic Motors from Mexico*, NY N302707 (Mar. 18, 2019) (finding the manufacturing processes in Mexico "that produce the motor substantially transforms the raw materials and various components into the electric motor."); *The Country of Origin of Printed Circuit Board Assemblies (PCBA) From Taiwan*, NY N301524 (Nov. 26, 2018) (finding the "manufacturing processes performed in Taiwan constitutes substantial transformation of the original articles into a new or different article of commerce."); *U.S. Government Procurement; Country of Origin of Gyrocompass; Substantial Transformation*, HQ H287851 (Apr. 24, 2018) (finding "Because of the change in name, character, and use that occurs in the United States, and considering the totality of the U.S. assembly operations, amount and importance of U.S. materials, and testing that will occur in the United States, the country of origin of the gyrocompasses will be the United States.").

[v] *See U.S. Government Procurement; Country of Origin of Gyrocompass; Substantial Transformation*, HQ H287851 (Apr. 24, 2018). We note an additional ***eight*** decisions found substantial information of an end-product in a non-designated country (*i.e.*, China, Vietnam, the Philippines, etc.). *See The Country of Origin of a Universal Bill Acceptor*, NY N306741 (Nov. 13, 2019); *The Country of Origin of a Programmable Robot*, NY N306903 (Nov. 12, 2019); *The Country of Origin of the CX4R Oxygen Sensor*, NY N306663 (Oct. 29, 2019) (finding assembly processes in China substantially transforms the end product); *The Country of Origin of a Charge Adapter Set from Vietnam*, NY N304932 (Jul. 10, 2019) (finding Chinese components are substantially transformed in Vietnam "into a new and different article of commerce with a name, character, and use distinct from the individual components"); *The Country of Origin of a Charge Adapter Set from Vietnam*, NY N304850 (Jul. 8, 2019) (finding Chinese components are substantially transformed in Vietnam "into a new and different article of commerce with a name, character, and use distinct from the individual components"); *The Country of Origin of Switching Power Supplies from Vietnam*, NY N304854 (Jul. 8, 2019) (finding assembly processes in Vietnam substantially transform Chinese components); *Country of Origin of an Incomplete Postage Meter*, HQ H303529 (Jun. 6, 2019) (finding substantial transformation of the print axis occurred in China); *The Country of Origin of a Modular Power Supply from Vietnam*, NY N302617 (Feb. 15, 2019) (finding manufacturing processes in Vietnam constituted substantial transformation).

[vi] *See, e.g.*, *U.S. Government Procurement; Country of Origin of Network Tap; Substantial Transformation*, HQ H280619 (Apr. 18, 2017) (noting because "there are two foreign components,

neither of which are substantially transformed by further processing in the United States," and because "the adapters are from a designated country (Taiwan) and the splitters are from a non-designated country (China), and both are incorporated into one end-product (the Slim Tap), it still needs to be determined which of these two countries is the country of origin").

[vii] *See The Country of Origin of a Programmable Robot*, NY N306903 (Nov. 12, 2019); *The Country of Origin of Linear Actuators*, NY N305467 (Aug. 8, 2019) (finding "the assembly operations performed in Taiwan, which consists of 21 assembly steps beginning with individual components processed into subassemblies, and then final assembly into a functional motor actuator, is significant and effects a change in the components as well as the electric motor."); *Country of Origin of an Incomplete Postage Meter*, HQ H303529 (Jun. 6, 2019) (finding "the assembly in China to create the incomplete postage meter is extensive and complex as all of the components of the incomplete postage meter, with the exception of the print axis, are assembled in China and the final assembly of those components with the print axis component occurs in China."); *U.S. Government Procurement; Country of Origin of Gyrocompass; Substantial Transformation*, HQ H287851 (Apr. 24, 2018) (finding that "the assembly processes that will occur in the United States are complex and time-consuming," and that "the large number of individual components, the 4.2 hours that will be spent assembling the boards, the ten hours that will be spent manufacturing the metal housing, the seven and a half hours that will be spent on final assembly, and the time spent on final calibration testing (up to 24 hours) are evidence of complex and meaningful assembly operations in the United States.").

[viii] *See also*, *Country of Origin of Certain Wearable Electronic Smart Devices; Substantial Transformation*, HQ H302801 (Oct. 3, 2019); *The Country of Origin of a Battery Rack System*, NY N306055 (Sept. 27, 2019); *The Tariff Classification and Country of Origin of Bicycle Racks*, NY N306015 (Sept. 20, 2019); *The Country of Origin Marking of a Desktop Personal Computer*, NY N305852 (Sept. 6, 2019); *The Country of Origin of Solar Modules from Vietnam*, NY N305538 (Aug. 12, 2019); *The Country of Origin of Fiber Optic Connectors*, NY N305277 (Aug. 1, 2019); *The Country of Origin of Air Vents*, NY N304657 (Jul. 3, 2019); *The Country of Origin of Solar Modules from Jordan; Section 201 Trade Remedy; 9903.45.25, HTSUS*, NY N304511 (Jun. 21, 2019); *The Country of Origin of the Contactless Reader Module from Taiwan*, NY N304425 (Jun. 12, 2019); *Country of Origin; Substantial Transformation; Solar Cells; Solar Panels; Applicability of Section 201 Safeguard Measures*, HQ H301813 (May 24, 2019); *The Country of Origin, Marking, and Applicability of Section 301 Trade Remedy of the LED Whitening Device*, NY N302526 (Mar. 4, 2019); *Modification of NY N227976; Country of Origin Marking; Solar Panels*, HQ H298653 (Nov. 19, 2018); *The Country of Origin of Tap Drive Sled Assemblies From the Netherlands or Germany*, NY N301213 (Nov. 13, 2018); *U.S. Government Procurement; Country of Origin of Monochrome Laser Printers and Replacement Toner Cartridges*, HQ H287548 (Mar. 23, 2018); *U.S. Government Procurement; Country of Origin of Network Tap; Substantial Transformation*, HQ H280619 (Apr. 18, 2017).

[ix] *See also*, *Reconsideration of HQ H301619; Preferential Tariff Treatment under NAFTA*, HQ H305370 (Oct. 11, 2019); *Reconsideration of NY N301484; Preferential Tariff Treatment Under NAFTA*, HQ H302480 (Sept. 13, 2019); *The Country of Origin of Printed Circuit Board Assemblies (PCBA) From Taiwan*, NY N301524 (Nov. 26, 2018); *The Classification and Country of Origin of Electronic Generators from China*, NY N301460 (Nov. 26, 2018); *The Classification and Country of Origin of Electronic Bus Bars from Mexico*, NY N301448 (Nov. 19, 2018); *U.S. Government Procurement; Country of Origin of Gyrocompass; Substantial Transformation*, HQ H287851 (Apr. 24, 2018); *Light Emitting Diode Video Display Cabinets*, HQ H292849 (Apr. 19, 2018).

[x] *See Country of Origin of an Incomplete Postage Meter*, HQ H303529 (Jun. 6, 2019).

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