Corporate Counsel

Lessons From Recent Developments on US-China Trade

With the threat of a veto for any restriction on presidential power, it appears unlikely that the trade war will be resolved legislatively. Nor is a judicial stop to the escalation likely.

By **Priya R. Aiyar** | August 20, 2018

The push-pull of U.S.-China trade relations has continued over the past month. While both Congress and the president have moderated some earlier stances on Chinese investment in the United States, the president has also made new threats to impose tariffs on the full range of imports from China. Congressional opposition to tariffs has gained momentum, but without a must-pass legislative vehicle—and with the threat of a veto—passage of proposed legislation is unlikely. In the meantime, legal challenges to recent tariffs are proceeding before the Court of International Trade and the World Trade Organization, but with limited prospects to alter policy in the near term. In sum, although both Congress and the administration have been willing to shift some prior positions on Chinese investment and trade in response to business concerns, larger trade disputes continue to escalate and are unlikely to be resolved legislatively or judicially.

FIRRMA Legislation—A Substantial Expansion but Less Sweeping Than Its Original Form

On Monday, Aug. 11, President Donald Trump signed the National Defense Authorization Act for fiscal year 2019 (NDAA) into law. That legislation includes the Foreign Investment Risk Review Modernization Act (FIRRMA), which expands the jurisdiction of the Committee on Foreign Investment in the United States to review foreign investment in U.S. businesses, as well as the Export Control Reform Act of 2018, which provides a permanent statutory basis for existing export controls on dual-use items and creates a new process to establish controls on "emerging or foundational technologies" that are critical to U.S. national security.

FIRRMA was motivated by concern over foreign and, in particular, Chinese investment aimed at acquiring or accessing U.S. technology and intellectual property. It gives the U.S. government new authority to review and potentially block investments in real estate near sensitive sites as well as minority investments in U.S. companies involved with critical technologies, critical infrastructure, or sensitive personal data of U.S. citizens. While it does not "blacklist" or "whitelist" countries as prior versions of the legislation did, it allows CFIUS to "specify criteria to limit the application of [FIRRMA] to the investments of certain categories of foreign persons"—e.g., to limit application of the new provisions to investors from certain

Although the final version of FIRRMA creates significant new hurdles for foreign investment, it is substantially less sweeping than the original draft, and was revised in response to concerns from the U.S. business and investment communities and other stakeholders. Input from these sources resulted in removal of a provision that would have subjected outbound technology transfers to CFIUS review (which

was supplanted by the new process regarding the establishment of export controls on certain critical technologies), as well as a more specific and less narrow definition of "passive" investments. Covered investments now include investments that afford the foreign person access to "material nonpublic technical information"; board observer rights or the right to nominate a board member; or involvement in substantive decision-making other than by voting shares. Moreover, there is a carve-out for foreign limited partners in investment funds, who may participate in the fund's advisory board or committee without triggering CFIUS review if certain conditions are met.

The final version of the bill also moderated prior language regarding Chinese telecom company ZTE. President Trump had ordered the Commerce Department to reverse a "denial order" cutting ZTE off from U.S. parts and suppliers and to renegotiate a settlement with ZTE on different terms. A number of senators and representatives opposed this reversal and sought to reimpose the denial order in the draft bill. However, the Administration position prevailed in the final bill, which banned ZTE from federal government procurement but did not reimpose the export ban. Finally, the imminent passage of FIRRMA caused President Trump to reverse course on a prior threat to impose additional foreign investment restrictions specific to China under the International Emergency Economic Powers Act.

The final version of FIRRMA thus represents a strong but moderated stance on foreign investment, and the lifting of the ZTE denial order represents potential Administration willingness to compromise on trade issues. The Administration's threats of additional tariffs, however, meant that China did not respond to the reversal on ZTE by approving the Qualcomm-NXP deal, which had been approved in eight other jurisdictions and whose fate before the Chinese Ministry of Commerce was widely regarded as tied to the outcome of the ZTE case. Instead, the Chinese government struck a blow to a U.S. company by refusing to approve the deal and causing Qualcomm to pay a $2 billion breakup fee to NXP.

Escalation on Tariffs—Legislative, Litigation Responses

The administration has imposed tariffs on Chinese goods under a number of different statutory provisions in 2018. The most recent escalation has involved tariffs imposed under Section 301 of the Trade Act as a response to the president's finding that China engaged in unfair trade practices. U.S. tariffs on $34 billion of Chinese goods have already taken effect, with another $16 billion scheduled to take effect later this month. China retaliated with its own tariffs on $50 billion of U.S. goods. The administration then proposed to raise tariffs from 10 percent to 25 percent on another $200 billion of Chinese imports. China retaliated again, and Trump responded by threatening to eventually impose tariffs on the full $500 billion of U.S. imports from China.

As this trade tit-for-tat continues, congressional Republicans have expressed increasing concern about its economic ramifications and proposed several pieces of legislation to curb the president's authority to impose tariffs. Any such legislation, however, would have limited prospects of success without being attached to a must-pass vehicle to insulate it from a veto threat. Sens. Bob Corker and Pat Toomey proposed a bill that would have required congressional approval for tariffs based on national security grounds (e.g., the steel and aluminum tariffs and the proposed auto tariffs), but failed to secure a vote on attaching that legislation to the NDAA or the Farm Bill. Sen. Rob Portman, along with Sens. Joni Ernst and Doug Jones, introduced a bill to give the Defense Department (rather than the Commerce Department) power to decide whether tariffs

are justified by national security concerns. But so far the Senate has only passed a nonbinding resolution instructing the negotiators of a spending bill to include language giving Congress a role in imposing national-security tariffs. Moreover, prospects for passage of trade-related legislation are weaker in the House than in the Senate. With the threat of a veto for any restriction on presidential power, it appears unlikely that the trade war will be resolved legislatively.

Nor is a judicial stop to the escalation likely. Companies have taken two different tacks in challenging national security tariffs in the Court of International Trade. Steel exporter Severstal argued that the tariffs were motivated by economic concerns, not national security concerns, and thus outside the scope of the president's authority under Section 232. In denying a preliminary injunction, the court disagreed, stating that Section 232 allowed consideration of economic factors. The American Institute for International Steel took a different approach to challenging the same steel tariffs, arguing not that the president exceeded his authority under Section 232, but that the statute itself is an unconstitutional delegation of legislative authority to the president. The Institute may face an uphill battle, however, given the U.S. Supreme Court's prior decision in Federal Energy Administration v. Algonquin SNG, which found that Section 232 did not raise constitutional nondelegation concerns.

Finally, China and other countries have challenged the Trump administration tariffs in proceedings before the WTO. The United States has also brought WTO challenges to China's trade practices and retaliatory tariffs. The WTO suits, however, may take years to resolve, and pose novel questions regarding the scope of the "national security" exemption invoked by the United States. The United States has also blocked appointments to the WTO Appellate Body based on problems it has alleged with the Appellate Body's functioning; without a resolution, the Appellate Body may not have enough members to issue rulings beginning in 2020.

What's Next?

In sum, a timely legal resolution of the various U.S.-China trade disputes is unlikely, and the administration's approach to those issues, rather than that of Congress, is likely to be dispositive. Neither Trump nor Chinese President Xi Jinping has yet shown willingness to back down on tariffs, though both may be subject to increasing internal pressure, with a falling stock market and weakening currency in China and upcoming midterm elections in the United States. So far congressional Republicans and Democrats have not succeeded in allying to shift the direction of trade policy, but a change in the makeup of Congress along with economic developments could strengthen the hand of free-trade Republicans and members of the administration who support a less adversarial approach on trade.

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