

# New AD/CVD Regulations Continue US Crackdown on Tariff Evasion

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On September 20, 2021, the U.S. Department of Commerce (Commerce) published a 282-page overhaul of antidumping and countervailing duty (AD/CVD) regulations, representing the most significant update to AD/CVD rules in 20 years. The new regulations, which generally track draft rules proposed in August 2020, are the latest effort in Commerce's recent push to address tariff circumvention.<sup>1</sup> Companies should be aware of the tools and strategies at the U.S. government's disposal as tariff circumvention moves higher on the enforcement agenda.

The new rules cover areas that are particularly relevant to tariff evasion: scope inquiries, circumvention inquiries and covered merchandise referrals from Customs and Border Protection (CBP). Overall, these regulatory changes are intended to enhance and harmonize the various processes at Commerce's disposal to detect tariff evasion and dovetail with a broader crackdown on the practice.

## Scope Inquiries

The way that Commerce defines the "scope" of an AD/CVD order can determine whether enforcement action or nonenforcement results. Scope definition is a threshold matter in a circumvention inquiry, because circumvention enforcement targets goods that would have been within the scope of an order but for attempts to evade the duties (e.g., when a party carries out minor alterations to a product in a third country to avoid tariffs).

Under Title VII of the Tariff Act of 1930 (the Tariff Act), upon issuance of an AD/CVD order, Commerce must provide a description of the class or kind of merchandise subject to the order. This determines the scope of the order, and Commerce has wide latitude under the statute to define the scope by interpreting the original AD/CVD petition. Once Commerce has defined the scope, determining whether particular goods are in scope and subject to duties falls to CBP. An interested party may seek a "scope ruling" and Commerce may conduct a "scope inquiry" to address uncertainty over whether certain types of goods are subject to the order, but the Tariff Act offers no procedures or standards for Commerce to use when issuing a scope ruling.

The new regulations specify these procedures and standards, both by codifying existing practices and instituting new ones. Key provisions include:

- **Standardized Scope Ruling Application:** The regulations contain new, standardized requirements for an interested party to submit a scope ruling application. Previously, no standardized application was available. This change is expected to allow Commerce to issue scope rulings more efficiently.<sup>2</sup>

<sup>1</sup> In addition to addressing tariff evasion, the new AD/CVD rules set out documentation requirements for new shipper reviews, codify procedures for importer certifications and set deadlines for submission of comments on industry support when Commerce considers initiating an AD/CVD investigation.

<sup>2</sup> 19 C.F.R. § 351.225(c). The scope ruling application now must include the following elements: (i) a detailed description of the product and its uses, including its physical characteristics; the countries of production, export and origin; the tariff classification; photographs or other exemplars providing a physical description; and a description of the production process; (ii) a concise public summary of the above information; (iii) the name and address of the producer, exporter and importer; (iv) a narrative history of the production of the product; (v) the volume of annual production; (vi) information and documentation related to the product's entry into the U.S.; (vii) a statement as to whether the product will undergo additional processing after importation; (viii) a statement as to whether the product is covered by the scope of an order; and (ix) factual information supporting the applicant's position.

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- **Country of Origin Determinations:** The rules set out a list of factors for Commerce to consider when conducting country-of-origin analyses. These factors will inform Commerce's determination of the point in production at which a good's country of origin is established (the "substantial transformation" test).<sup>3</sup> The rules give Commerce wide discretion by specifying that the factors are nonexhaustive, that Commerce is not bound by other agency findings (including those of CBP) and that Commerce may decline to apply the substantial transformation test if the agency determines that the test is not appropriate for a particular product.
- **Scope Ruling Analysis:** The new regulations clarify the analysis that Commerce must undertake when conducting a scope inquiry. Among other specifications, the regulations codify the hierarchy of sources Commerce may use to interpret an order, as well as the way in which the agency analyzes component parts of larger products (*i.e.*, "mixed-media analysis").<sup>4</sup>

## Circumvention Inquiries

The new regulations also set out procedures for circumvention inquiries and determinations. Commerce has statutory authority to conduct circumvention inquiries to determine whether certain types of products should be included within the scope of an AD/CVD order. Through these inquiries, Commerce can impose duties on goods that have been altered to evade an order, for instance through minor manufacturing changes or through "transshipment" to a third country not subject to the original order.

Key procedures include:

- **Self-Initiation:** Commerce has the power to self-initiate a circumvention inquiry whenever the agency determines from available information that an inquiry is warranted, such as in the course of a scope inquiry. Although courts previously found

that Commerce had the power to self-initiate,<sup>5</sup> the new regulations codify Commerce's ability to do so whenever the facts suggest such an inquiry is appropriate.<sup>6</sup>

- **Circumvention Inquiry Requests:** The regulations set out the requirements for an interested party to request a circumvention inquiry.<sup>7</sup> Importantly, these requirements mirror the information required of a party filing an application for a scope ruling.
- **Third-Country Processing and Assembly:** The regulations identify the factors that Commerce must apply when conducting an analysis of third-country processing and assembly. While this analysis is somewhat similar to the country-of-origin analysis conducted in scope rulings, Commerce has noted that the two serve distinct purposes. Country-of-origin analysis is built around the substantial transformation test, while third-country analysis is designed to detect circumvention through minor alterations to merchandise in a third country to hide the products' true production location, and so assesses different factors.<sup>8</sup>

## EAPA

The new regulations introduce procedures to enhance the "covered merchandise referral" mechanism available when CBP is conducting a tariff evasion enforcement action under the Enforce and Protect Act (EAPA).

Since its passage in 2015, the EAPA has become one of the most important tariff evasion enforcement tools available to the U.S. government. This statute allows CBP to investigate whether an entity has evaded AD/CVD duties, and provides for a process and deadlines for investigations, including rules governing participation by interested parties.<sup>9</sup> The EAPA is a particularly powerful tool because it allows CBP to implement "interim measures" after receipt of an allegation against a suspected tariff evader, before the completion of a full investigation and final determination. Additionally, the EAPA allows CBP to adopt an "adverse inference" against importers who fail to provide product information in the course of an investigation.

<sup>3</sup> 19 C.F.R. § 351.225(j). When conducting a substantial transformation analysis, Commerce will consider the following factors: (i) whether the product processed downstream is a different class or kind of merchandise than the upstream product; (ii) the physical characteristics of the product; (iii) the intended end use of the downstream product; (iv) the cost of production/value added of further processing in the third country; (v) the nature and sophistication of processing in the third country; and (vi) the level of investment in the third country.

<sup>4</sup> 19 C.F.R. § 351.226(k)(3). Commerce performs a mixed-media analysis when subject merchandise enters the United States in a set or kit with non-subject goods — for example, subject nails in a non-subject toolbox. The analysis is designed to determine whether such merchandise is within the scope of an order. Under the new regulations, analysis will consist of the following steps: (i) determining if the component product, standing alone, would be covered by an order; (ii) considering the language of the scope of the order to determine whether the component product's inclusion in the merchandise as a whole results in its exclusion from the scope of the order; and (iii) if Commerce cannot determine such an exclusion, considering (a) the practicability of separating the in-scope component for repackaging or resale; (b) the measurable value of the in-scope component as compared to the merchandise as a whole; and (c) the ultimate use or function of the in-scope component relative to the merchandise as a whole.

<sup>5</sup> See *Bell Supply Co. v. United States*, 888 F.3d 1222, 1230 (Fed. Cir. 2018).

<sup>6</sup> 19 C.F.R. § 351.226(b).

<sup>7</sup> 9 C.F.R. § 351.226(c).

<sup>8</sup> 19 C.F.R. § 351.226(i). These factors are grounded in Section 781(b) of the Tariff Act, and include whether the process of assembly or completion in the foreign country is minor or insignificant; whether the value of the merchandise produced in the country subject to the order is a significant portion of the merchandise exported to the U.S.; and whether the action is appropriate to prevent evasion of such order or finding.

<sup>9</sup> EAPA investigations apply only to AD/CVD orders, but some regulators have proposed extending the statute to cover evasion of duties imposed pursuant to other tariff statutes, such as Section 301.

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The new AD/CVD regulations strengthen the EAPA process by creating procedures for “covered merchandise referrals.” These referrals occur when, during an EAPA investigation, CBP is unable to determine whether merchandise is covered by the scope of an AD/CVD order and refers the question to Commerce for determination pursuant to Section 517(b)(4)(A) of the Tariff Act. Previously, no formal procedures had been established to govern Commerce’s review of these referrals. The new regulations establish deadlines for completing covered merchandise inquiries and submissions, and specify that Commerce may address a covered merchandise referral as part of a scope inquiry or circumvention inquiry.<sup>10</sup>

In its response to comments regarding the new regulations, Commerce observed that “there is a potential significant overlap” between the inquiry that Commerce undertakes in response to a covered merchandise referral, on the one hand, and a scope inquiry or circumvention inquiry, on the other. Commerce noted that it has sought to “mirror” language in the three regulations, indicating that administrative or judicial interpretations of any one regulation may have important implications for the other two.

## Enforcement Trends

These regulatory changes echo the broader crackdown on tariff evasion that has occurred in recent years. Between 2016 and 2020, CBP launched 131 EAPA investigations and identified over \$600 million in additional AD/CVD duties owed to the U.S. government. EAPA enforcement has exhibited a strong upward trend, with 64 (almost half) of these investigations occurring in fiscal year 2020 alone. CBP has reported that a majority of its EAPA investigations in 2020 involved Chinese goods transshipped through third countries, particularly in Southeast Asia.

Likewise, the number of circumvention inquiries conducted by Commerce have increased sharply in recent years. Between 2016 and 2020, Commerce initiated 30 circumvention inquiries, 9 of which were self-initiated. This represents a 114% increase over the previous four-year period.

CBP’s recent determination that multiple furniture companies had been evading AD/CVD orders illustrates the type of conduct that U.S. authorities are trying to target. In October 2020, MasterBrand Cabinets, Inc. (MasterBrand) submitted an allegation to CBP that four wooden cabinet importers were misrepresenting goods manufactured in China as originating in Malaysia in order to circumvent duties applied to China. CBP initiated an investigation after finding that the allegation “reasonably suggested” evasion, and in February 2021, CBP implemented interim measures against the importers. CBP submitted requests for information to each importer, as well as to Rowenda Kitchen, the Malaysian manufacturer of record, and received written arguments from several importers and MasterBrand.

In its analysis, CBP noted that the evidence of transshipment consisted of three key sources: trade data showing surges of imports into Malaysia from China (and into the United States from Malaysia) of merchandise under tariff classifications subject to a recent CVD order against China; company-specific shipment data indicating that Rowenda began shipping wooden cabinets to the U.S. in the same month that CVD measures were imposed; and an affidavit from a market research firm indicating that Rowenda had close relationships with Chinese manufacturers and that its facilities were not equipped for substantive manufacturing activities. Because Rowenda and two of the importers did not cooperate with CBP’s investigation, this evidence created an adverse inference against these parties. On September 16, 2021, CBP determined that tariff evasion had occurred.

CBP’s determination reflects a heightened emphasis on enforcement that is poised to continue for the foreseeable future. Companies that import goods from countries that have been the target of recent enforcement actions — particularly countries in Southeast Asia such as Malaysia and Vietnam — should vigilantly monitor their supply chains to ensure that tariff evasion does not occur. Conversely, companies manufacturing goods in the United States that compete with imported products should consider whether these imports unfairly benefit from tariff evasion, and if responsive action is appropriate.

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<sup>10</sup> 19 C.F.R. § 351.227(2).