insights

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No Unilateral Action—WTO Panel Ruled U.S. Section 301 Tariffs on Chinese Imports Inconsistent with WTO Obligations

Introduction

On September 15, 2020, a World Trade Organization (WTO) panel issued a ruling[1] holding tariffs imposed by the United States against Chinese goods inconsistent with U.S.'s WTO obligations under the GATT. This is a new development in the ongoing trade disputes between the U.S. and China, focusing particularly on the issue of intellectual property rights (IPR) protection and the ability to take unilateral retorsion measures when a state deems the other to have failed its commitments.

Title III of the Trade Act of 1974 (collectively, Section 301) authorizes the U.S. Trade Representative (USTR) to impose trade sanctions when it determines foreign practices violate U.S. trade agreements or are unjustifiable and burden or restrict U.S. commerce, including the failure to adequately protect IPR. With the advent of the WTO, USTR undertook to initiate WTO proceedings if it found foreign practices violating WTO Agreements,[2] and it has since then initiated 33 Section 301 investigations, including a 2017 investigation against China over IPR protection.[3] The 2017 Section 301 investigation concluded that despite some positive progress, China's practices in technology transfer, technology licensing terms, acquisitions of U.S. technology, and trade secrets protection were unreasonable or discriminatory, and burdened or restricted U.S. commerce.[4] Based on that Section 301 Report, the U.S. imposed two batches of duties, the first being the 25 percent taxes imposed on June 6, 2018, and the second additional duties of 10 percent on September 21, 2018, which was increased to 25 percent on January 1, 2019. Section 301 sanctions have been subject to prior WTO disputes, and WTO jurisprudence holds that Section 301 sanctions are not *per se* WTO-

inconsistent so long as they were implemented in a manner congruent with WTO obligations.[5] However, their use in specific cases would call for close scrutiny.[6]

In this dispute, China accused the U.S. of violating its commitments under the Most-Favoured-Nation obligation (GATT Art. I:1) and under its tariff bindings (GATT Art. II:1(a) and (b)) by imposing the aforementioned duties on Chinese goods. The U.S. responded that the issue had been resolved through a "settlement,"[7] or alternatively, that the challenged tariffs were justified under the GATT exception allowing WTO members to take measures "necessary to protect public morals." The U.S. also argued that the January 2019 tariffs increase fell outside the panel's jurisdiction.

"Mutually Satisfactory Solution" by the United States and China

Parallel negotiations between disputing parties are encouraged by the WTO dispute settlement. In its Report, the Panel rejected the U.S.'s position that the issue had been resolved under a "mutually satisfactory solution" as the U.S. and China "have reached their own solution" through ongoing interactions (tit-for-tat retaliatory tariffs imposed by both countries) and bilateral negotiations.[8] According to the Panel, there was no "mutually satisfactory solution" because China, the other party to the dispute, "clearly disagree[d] that the parties ha[d] reached a mutually satisfactory solution." Moreover, mutually agreed solutions must be officially notified to the WTO, which was not the case here.

Even the December 2019 Phase One Trade Agreement between the U.S. and China failed to change the Panel's conclusion. Indeed, the Panel buttressed its reasoning by noting the lack of reference to the agreement and the reservation of WTO rights specifically under the Phase One Trade Agreement. Moreover, the Panel left open the question on the compatibility of the Phase One Agreement with its ruling.[9]

Most-Favoured-Nation (MFN) Violation and Unlawful Tariff Increases

The Panel found that the challenged measures inconsistent with the U.S.'s MFN obligation requiring the U.S. to treat products from China no less favorably than the comparable products from other countries. By targeting China with the additional duties, the U.S. breached its MFN obligation. The Panel also found that the U.S. had increased tariffs beyond what was allowed by its schedule of concessions under GATT Art. II:1(a) and (b). All WTO members are bound by their tariff schedules as annexed to the GATT ("bound rates" are the highest tariff rates a member may impose on foreign products), and WTO members may not apply tariffs in excess of the rates specified in their schedules.

The U.S. did not appear to dispute China's claims, but mostly sought to justify its tariffs under the General Exceptions provision of the GATT.

On the jurisdictional issue of the January 2019 tariff increase, the Panel held that both China's complaint and the tariffs measures originally challenged anticipated such an increase. Numerous WTO disputes have dealt with the issue of measures changing over the course of the adjudication process, and panels and the Appellate Body have found amendments to an original measure within the scope of the claims.

Art. XX(a) "Public Morals" Justification

In defense, the U.S. argued that the challenged measures were justified under the GATT's "public morals" exception. GATT Art. XX(a) allows WTO members to take measures "necessary to protect public morals" so long as the measures are applied in a non-discriminatory fashion and are not a disguised restriction to trade. The U.S. contended that practices documented in the Section 301 Report violate the public morals prevailing in the U.S. and that some of these actions are subject to criminal penalty. The U.S. also considered such unfair competitive practices "as a threat to the preservation of its democratic political and social institutions." Thus, the U.S. asserted that the elimination of such conducts preserves public morals, and that the measures were necessary as they encouraged China to agree to enter into negotiations with the U.S. and aimed at influencing China's policies and practices.

China, in contrast, argued that criminalizing conduct is not, by itself, sufficient to prove a public morals objective, and "public morals" should be limited to non-economic concerns and do not encompass economic policy concerns. China contended for measures to be "designed" to protect public morals, they shall be "appl[ied] to goods that embody content or conduct offensive to public morals." China also maintained that the measures were unnecessary because any benefit was significantly outweighed by the measures' trade restrictiveness.

The Panel rejected the U.S.'s "public morals" justification. The Panel adopted the holistic analytical method considered by prior WTO adjudicators, namely, (1) determine whether the claimed policy is a "public morals" objective within the meaning of Article XX(a), (2) assess whether the measure is "designed" to protect that public morals objective, and (3) determine whether measures are "necessary" to protect public morals based on a process of "weighing and balancing" different factors.

The Panel agreed with the U.S. that "public morals" denote a standard of right and wrong, which could be ascertained by factors including "prevailing social, cultural, ethical and religious values." It recognized the deference that WTO Members enjoy when defining "public morals." The Panel concluded Art. XX in general, and the "public morals" exception in particular, may include economic concerns, counter to China's argument. It recognized that the public morals the U.S. identified appeared to be highly important. According to the Panel, the U.S. "must demonstrate how the additional duties are apt to contribute to the public morals objective." After examining the selection and exclusion processes of products to be covered by the challenged measures, the Panel concluded the U.S. failed to explain the relationship between the measures and the public morals objective it pursued. Rejecting the U.S.'s assertion that the measures were necessary to address Chinese industrial policies, including Made in China 2025, the Panel found that the products subject to additional tariffs were not closely related to the industries identified in the Section 301 Report and suggested the measures were based on other economic considerations rather than the public morals objective. The Panel, in footnote 456, implicitly voiced its disapproval of imposing unilateral retaliatory tariffs under the "public morals" exception instead of using the multilateral authorization of the WTO.

What Implications for the Phase One Deal and Other WTO Cases?

Many observers believe that this Panel Report is unlikely to yield any substantive result should the U.S. appeal the Report to a now dormant Appellate Body. An appeal by the U.S. would effectively prevent the Panel's findings from becoming binding because it would delay indefinitely its adoption by WTO members per the normal procedure.[10] Therefore, it appears to be a long way before the U.S. removes additional tariffs found inconsistent with the WTO obligations but that are nevertheless left intact in the Phase One Agreement.[11] On the jurisprudence of the "public morals" exception, and more specifically, on using this exception to address industrial policies, the Panel seems to suggest that the mere assertions that products falling within certain industries believed to benefit from the challenged industrial policies are insufficient.

Another WTO dispute brought in March 2018 by the U.S. against China[12]—but now suspended—specifically challenged China's laws, regulations, and measures relating to IPR protection, *inter alia*, patent enforcement restrictions and forced technology transfer.[13] Although both issues are identified in the Section 301 Report,[14] the Section 301 Report was not referenced in *China — IPR II*. Interestingly, *China — IPR II* is not referenced in the Panel Report or in the Addendum that summarized parties' and third parties' arguments either. The concurrent WTO proceeding may have served as yet another venue to address concerns highlighted in the Section 301 Report.

The Phase One Agreement and Chinese legislation, regulations, and judicial interpretations seem to have addressed some issues identified in the Section 301 Report.[15] In the Phase One Agreement, China undertakes to enhance intellectual property rights protection and refrain from forcing technology transfer.[16] China amended its Technology Import and Export Regulation in 2019,[17] removing patent enforcement and transfer restrictions that are concerns in the Section 301 Report. The new Foreign Investment Law and its implementing regulation explicitly forbid forced technology transfer.[18] More recently, the People's Supreme Court of China further specified the scope of trade secrets and factors to consider in trade secret cases.[19] However, as noted earlier, the Panel did not opine on potential impacts of its Report on the Phase One Agreement. So far, the Phase One Agreement seems to be intact,[20] and likely will remain so unless one of the Parties decides to abrogate it.

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[1] Panel Report, *United States—Tariff Measures on Certain Goods from China*, WTO Doc. WT/DS543/R (adopted Sept. 15, 2020), https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/DS/543R.pdf&Open=True [hereinafter Panel Report].

[2] Uruguay Round Statement of Administrative Action (H.Doc. 103-316), https://www.congress.gov/bill/103rd-congress/house-bill/5110/text

[3] Andres B. Schwarzenberg, *Section 301 of the Trade Act of 1974*, Cong. Res. Serv. (last updated Aug. 31, 2020), https://crsreports.congress.gov/product/pdf/IF/IF11346.

[4] Office of the United State Trade Representative, *2018 Special 301 Report*, pp. 38-44, https://ustr.gov/sites/default/files/files/Press/Reports/2018%20Special%20301.pdf [hereinafter Section 301 Report]

[5] Panel Report, *United States — Sections 301–310 of the Trade Act 1974*, WTO Doc. WT/DS152R, ¶ 7.126.

[6] *Id.* ¶ 7.136.

[7] World Trade Organization, *Understanding on Rules and Procedures Governing the Settlement of Disputes*, art. 12.7, https://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm#12

[8] Panel Report (Add.), *United States—Tariff Measures on Certain Goods from China*, WTO Doc. WT/DS543/R/Add.1, Annex B-2, Integrated Executive Summary of the Arguments of the United States, ¶¶ 21-32, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/DS/543RA1.pdf&Open=True. *See also* Panel Report, *supra* note 1, ¶ 7.10.

[9] Commentators do not seem to be concerned with the WTO compatibility of the Phase One deal. *See* Ana Swanson, *W.T.O. Says American Tariffs on China Broke Global Trade Rules*, THE NEW YORK TIMES, Sept. 15, 2020, https://www.nytimes.com/2020/09/15/business/economy/wto-trade-china-trump.html

[10] *Supra* note 7, art. 16
[11] David Gantz, Sergio Puig, and Jingyuan Zhou, *The Scorecard of the Phase One Trade Agreement*, EJIL:TALK!, Feb. 14, 2020.
[12] *DS542: China — Certain Measures Concerning the Protection of Intellectual Property Rights* (*China — IPR II*). The proceeding was suspended on June 8, 2020, following the U.S. request, *China — Certain Measures Concerning the Protection of Intellectual Property Rights, Communication from the Panel*, WT/DS542/14.
[13] *Id.*
[14] Office of the U.S. Trade Representative, supra n 4, p.5.
[15] Gantz et. al, *supra* note 11.
[16] *Id.*
[17] arts. 24 and 27, Technology Import and Export Regulation, http://www.gov.cn/gongbao/content/2019/content_5468926.htm.
[18] Gantz et. al, *supra* note 11.
[19] Interpretation of the SPC on Several Issues Concerning the Application of Law in the Trial of Civil Cases of Disputes over Infringement of Trade Secrets (effective Sept. 12, 2020), http://www.court.gov.cn/zixun-xiangqing-254751.html.
[20] USTR states that "It is important to note that this report has no effect on the historic Phase One Agreement between the United States and China." *WTO Report on US Action Against China Shows Necessity for Reform*, Office of the United States Trade Representative, Sept. 15, 2020, https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/september/wto-report-us-action-against-china-shows-necessity-reform.