Volvo, Substantial Transformation and Proof of Life

[Updated, but just to fix my terrible typing.]

First, let's get the easy part out of the way. Yes, I am alive. My side projects, including this blog, have been collateral damage in the trade war. I have been diligently working on client matters and other projects. I'm not sorry for that, but I am unhappy it has reduced my blog to a shadow of what I want it to be. I never want the blog to be stale, but it happens. I will note that there have been very few customs decisions from the Court of International Trade and Court of Appeals for the Federal Circuit. On the other hand, there have been a few trade cases that have important implications for importers and, you may have noticed, there have been a lot of agency and presidential actions. Be sure to watch my Twitter feed for breaking news. In the meantime, I am trying to get rolling again.

Speaking of rolling, let's talk about the recent ruling Customs and Border Protection issued to Volvo. The ruling is HQ H302821 (Jul. 26, 2019). This is one of several recent origin rulings in which an importer asked CBP to confirm that the country of origin of a product assembled outside of China from materials that are at least in part from China is something other than China. Several have gone poorly (for example this, this and this.).

Much of the reasoning in these and similar rulings draws on the notion that assembly alone is not sufficient to produce a substantial transformation where the assembled parts had a predetermined end-use at the time of the assembly. This has led me to stomp around my office shouting that most assembled products are unlikely to satisfy this test. Modern assembly plants pull together pre-made components to make larger items. The fabrication of those components is often, but not always, outsourced to another facility. This allows parts to arrive just in time and be immediately provisioned to the line for use in assembly.

The example I often use when ranting about this is cars. It is hard to think of a major car part that does not have a predetermined end-use. It is also hard to image a production process that is more substantial and more transformative than making cars. Nevertheless, CBP seems to disagree.

First, let me not oversell my case. The Volvo ruling does not concern a traditional assembly process that starts with loose parts and ends with a vehicle. It involves what is known as knock down assembly. In this process, components were shipped to or sourced in China where they were assembled into major subassemblies. Those subassemblies and other major components were then shipped to Sweden. The Chinese subassemblies include painted bodies (sides, doors, tailgates, rear view mirrors, roofs, etc.); engine modules (engines, transmissions, front brakes, and radiators); and suspension modules (rear sub-frame, electric motors, rear suspension, rear brakes). Other components imported to Sweden include the hood, fuel tank, battery modules, instrument panel, seats, wheels, etc. In Sweden, all of those components came together to form a passenger car.

The issue presented to Customs was whether the vehicles built in Sweden from the Chines subassemblies and components are products of China or of Sweden. This matters for two reasons. First, vehicles of 8703.80.00, which these are, are subject to 25% Section 301 duties when they are products of China. Second . . . well . . . it's a Volvo; I suspect the company does not want to have to label them as products of China if they can avoid it.

To make the country of origin determination for purposes of the 301 duties, Customs applies the long-established (but ever changing) substantial transformation test. We should add some context before we move on.

The Court of Customs and Patent Appeals faced a country of origin marking question in United States v. Gibson-Thomsen Co., 27 C.C.P.A. 267 (1940). In that case, the imported merchandise was toothbrush and hairbrush handles from Japan. Id. at 268. At the time of importation, the handles were properly marked to indicate Japan as the country of origin. After importation, holes were drilled into the handles and bristles inserted and embedded into the holes. Id. at 269. This process removed the country of origin marking.

After reviewing the relevant law and regulations, the Court found:

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nothing in the statute nor in its legislative history to warrant a holding that the Congress intended to require that an imported article, which is to be used in the United States as material in the manufacture of a new article having a new name, character, and use, and which, when so used, becomes an integral part of the new article, be so marked as to indicate to the retail purchaser of the new article that such imported article or material was produced in a foreign country. On the contrary, we are of opinion that the Congress intended . . . to cover only such imported articles as do not lose their identity as such when combined with other articles.

Applying this analysis to the brushes, the Court concluded that the brush handles:

are so processed in the United States that each loses its identity in a tariff sense and becomes an integral part of a new article having a new name, character, and use. We are of opinion, therefore, that, at the time of their importation, the involved articles were marked "in such manner as to indicate to" the "ultimate purchaser in the United States"—the manufacturer of toothbrushes and hairbrushes—the country of their origin—Japan.

This conclusion by the Court of Appeals means that an imported brush handle, having the final shape and the clear intended end-use as a brush, was substantially transformed by the relatively simple operation of boring holes and embedding bristles in those holes. That is all that is necessary to substantially transform a Japanese brush handle into an American brush. Gibson-Thomsen remains a correct statement of the law and is often cited by Customs in its rulings without the context of the actual operations that resulted in a substantial transformation in that case.

Subsequent court cases have added details to this test. In Belcrest Linens v. United States, 573 F. Supp. 1149 (CIT 1983), aff'd 741 F.2d 1368 (Fed. Cir. 1984), the Court added that the determinative issue is the extent of operations performed and whether the parts lose their identity and become integral to the new article. This makes sense as it should not be the case that putting any two pieces together results in a substantial transformation. Customs applies this by saying that assembly operations that are minor or simple, as opposed to complex or meaningful will generally not result in a substantial transformation.

Note that this is a significant step away from the name, character, and use test that is the basis for substantial transformation. That test does not ask how the transformation occurred, only whether it was substantial. Under Belcrest, it is likely that the hairbrush considered in Gibson-Thomsen, would not be substantially transformed. But, the process at issue in Belcrest was cutting marked sections of fabric from a bolt, sewing them into pillowcases, adding a decorative thread, and packing them for resale. That is essentially one cutting step and one sewing step plus some less transformative operations. Nevertheless, in Belcrest, the Court found a substantial transformation from fabric to pillowcases.

The next step toward the Volvo ruling came in 1993 when the Court of International Trade decided National Hand Tool v. United States, 16 CIT 308 (Dicarlo, C.J.). [If you know my professional history, you will understand that what I am about to say is very personal.] National Hand Tool involved semi-finished forged tool parts (e.g., sockets and handles) that were subjected to finishing and some assembly in the United States. At the time of importation, the articles had their near final form and that form was not going to change as a result of the finishing operation. A flex handle remained a flex handle; it was just a heat-treated flex handle with a knurled grip. Faced with these facts, Chief Judge DiCarlo noted that "The use of the imported articles was predetermined at

the time of importation." He also said, "**The fact that there was only one predetermined use of imported article does not preclude the finding of substantial transformation.**"

This line of reason was taken up in Energizer Battery Inc. v. United States, 109 F. Supp 3d 1308 (CIT 2016). The issue there was the country of origin of a military-grade flashlight assembled in the U.S. with imported parts. This was a high-end device with electronics that provided control over how the light operated. The flashlight consisted of about 50 discrete parts including five LED's. Many of these parts were simple fasteners, others were specifically designed for this flashlight. The parts of the flashlight were ready for assembly when imported and did not require further manufacturing. Furthermore, the non-fastener parts were predetermined to be used in the assembly of the flashlights. The head assembly was made in China and contained the LED's, wires connecting the LED's to a printed circuit assembly. With that in mind, the Court looked at National Hand Tool and noted that:

when assembly operations were manual and required some "skill and dexterity to put components together with a screw driver" but the names of each article and the form and character of each component remained unchanged, and the use of the imported articles was predetermined at the time of importation, the court did not find that substantial transformation had occurred . . . .

After a thorough analysis of name, character, and use; whether the assembly was minor or simple; and the predetermined end-use of the parts, the Energizer court found no substantial transformation. The conclusion was focused on the character test and the predetermined end-use was evidence of no change in character.

It is true that the flashlight could be disassembled and the original parts removed. Yes, they retain their original names and forms. Nevertheless, the flashlight is more than the sum of the parts. It is a functional light and a distinct article of commerce. The assembled functional flashlight is far more distinct from the parts than was the Japanese brush handle discussed in Gibson-Thomsen. Following Gibson-Thomsen, the focus should be on the nature of the imported material compared the finished article. Provided the assembly is not simple and the new item is a distinct article of commerce, the law indicates that the transformation is substantial.

We need not ignore National Hand Tool to reach that conclusion. The facts of the case matter. National Hand Tool is fundamentally about finishing operations on unitary forgings not assemblies. Finishing metal parts is different than bringing together multiple disparate parts to form a working whole.

Back to the Volvo ruling . . . .

Customs correctly reviewed all of this, but landed, as is seemingly always the case now, on Energizer for its the guiding principles. Customs noted that in Energizer the court focused on the fact that the components of the flashlight retained their respective names after they were assembled and had a predetermined end-use at the time of importation.

Here is the decisive paragraph from the Volvo ruling:

In the instant case, five subassemblies are manufactured in China from components from various countries. The five subassemblies and other components from China with the exception of high voltage cables and wheels from Europe will then be assembled into the passenger vehicles in Sweden. Unlike the situation in HQ H155115, HQ H118435, and HQ H022169, in this case, the complex assembly process occurs when producing the subassemblies in China. ***With respect to the final assembly, we***

find the manufacturing processes of the five subassemblies in Sweden do not rise to the level of complex processes necessary for a substantial transformation to occur. Further, the five subassemblies from China have a pre-determined end-use and do not undergo a change in use due to the assembly process in Sweden. Accordingly, we find that based on the information provided, the subassemblies and the foreign parts that are imported to Sweden are not substantially transformed as a result of the assembly operations performed in Sweden.

Given the history of substantial transformation, this result is almost certainly wrong. First, it ignores or diminishes the clear statement from National Hand Tool (which was repeated in Energizer) that a predetermined end-use does not preclude a finding of substantial transformation. Second, CBP simply waives off the complexity of assembling a motor vehicle from subassemblies as if these parts were Legos. There is no conceivable way that these vehicles come together in a process that is less complex than putting bristles on a brush handle or cutting fabric and sewing pillowcases. It is almost certainly more complex than the 7-minute process of making flashlights in Energizer.

Customs' current love affair with predetermined end-use as indicative of simple assembly and of there being no change in character is turning into the crutch it uses to deny substantial transformation claims. That is not a smart application of National Hand Tool and does not give due recognition to the facts of that case and its statement that predetermined end-use does not preclude finding a substantial transformation. This was noted in Energizer even though that case declined to find a substantial transformation.

If the Volvo process of building cars in Sweden from Chinese origin subassemblies is simple, that fact is sufficient to find that the vehicles are of Chinese origin. The predetermined end-use of the subassemblies is a fact to consider but should not be dispositive. To be simple assembly, the process in Sweden should be compared to making pillowcases in Hong Kong from fabric woven, marked, and embroidered in China. Cars have lots of big, heavy moving parts that need to be connected just so. The assembly implicates important safety and regulatory requirements. The workers are likely skilled and using expensive tools and other equipment. I may be making an unsupported factual assumption, but it is inconceivable to me that this is a simple process compared to sewing pillowcases or making hairbrushes.

This ruling calls into question the applicability of substantial transformation to all assembled goods including assemblies as complex as (non-knocked down) motor vehicles, aircraft, and farm equipment. Essentially, the law has moved to require a double substantial transformation, or at least further processing of the parts prior to assembly. This is almost explicitly stated in a series of rulings on the origin of electric motors. See, for example, N302707 (Mar. 18, 2019) in which CBP noted the presence of component-level production in Mexico.

Energizer might be correct in its result. The lens head contained the control electronics and the light emitting parts of the flashlight. Perhaps that subassembly is the essence of the completed item, meaning there is no change in character after assembly. Nevertheless, the language used in Energizer does not recognize the unique fact that National Hand Tool was about finishing operations and only tangentially about assembly. This lack of clarity has either driven CBP down the wrong path or has allowed CBP to narrow substantial transformation to such a degree that it would be unrecognizable to the Court that decided Gibson-Thomsen.

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