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Commerce's New Currency Undervaluation Regulations Create Risks for Foreign Companies Seeking to Trade with the United States and for U.S. Importers

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February 18, 2020 – On February 4, 2020, the U.S. Department of Commerce ("Commerce") published new final regulations designed to make currency undervaluation actionable in countervailing duty proceedings. Under these regulations, if Commerce determines that a foreign government has undervalued its currency, Commerce is authorized to treat the extra amount of domestic currency that exporters and/or traders received from an exchange of U.S. dollars because of the undervaluation as a subsidy. These rules will apply to all new countervailing duty investigations and administrative reviews that begin on or after April 6, 2020.

In initially proposing these regulations on May 28, 2019, Commerce estimated that the new rule could result in the collection of over $3 billion in additional countervailing duties. Although the rules are not limited to any particular exporting countries, Commerce, in this May notice, suggested that as many as twelve countries, including China, South Korea, and India, could be considered to be undervaluing their currencies.

The regulations are designed to address the Administration's concern that various countries may be intentionally weakening the value of their currencies, or sustaining weak currencies, to gain a trade advantage—especially by making their exports to the United States less expensive. Such weakened foreign currencies may, however, benefit U.S. consumers who buy imports and U.S. businesses that rely on inputs from overseas. Previous administrations have examined this issue, but have delayed or resisted efforts to make currency undervaluation actionable out of concern that it could potentially lead to currency conflicts.

For a subsidy to be actionable under U.S. and international law, there must be a financial contribution by a governmental authority (or an entity entrusted or directed by an authority); a benefit to the recipient; and the

subsidy must be "specific" (generally meaning that it is limited to certain enterprises or industries either as a matter of law or a matter of fact). Commerce's new regulations address each of these elements.

Governmental Action. Commerce is taking the position that the receipt of domestic currency from an authority (or an entity entrusted or directed by an authority) in exchange for U.S. dollars could constitute a "financial contribution" under U.S. law. Commerce's new regulations provide that it "normally will make an affirmative finding of currency undervaluation only if there has been government action on the exchange rate that contributes to an undervaluation of the currency."

To determine whether a country's currency is undervalued, the regulations provide that Commerce "normally" will compare the country's real effective exchange rate (REER) to the real effective exchange rate that achieves an external balance over the medium term (equilibrium REER). In the preamble to the regulations, Commerce acknowledges that multiple valid methodologies may exist for calculating the equilibrium REER and that no single definition or formula necessarily fully captures a country's appropriate medium-term external balance. Commerce has therefore reserved for itself the flexibility to use an alternative methodology to calculate the equilibrium REER, and therefore flexibility in determining whether the currency is undervalued.

Benefit Calculation. Once the country's currency has been determined to be undervalued, any benefit calculations by Commerce will be company-specific and focus on the financial advantage provided to the exporter when it converts U.S. dollars into undervalued domestic currency. The regulations authorize Commerce to examine each individual exporter's currency exchanges and, potentially, add the amount of the benefit attributed to these currency exchanges to the exporter's overall countervailing duty rate.

Specificity. In order to make currency undervaluations actionable under U.S. and international countervailing duty law, Commerce also had to revise its definition of specificity. The new regulations provide that Commerce "normally" will consider "enterprises that buy or sell internationally" to comprise a group of enterprises or industries within the meaning of the Act. Commerce refers to this as the "traded goods sector." This change to the specificity definition is not limited to currency undervaluation, however, and may well have an impact on Commerce's treatment of other types of subsidy allegations.

Relationship to Treasury Department Determinations. The new regulations provide that Commerce will ask the U.S. Treasury Department ("Treasury") to provide its evaluation and conclusions as to currency undervaluation, foreign government action, and the amount of currency the exporter would have received absent the undervaluation of the foreign currency. In the preamble to the regulations, Commerce stated that it "will defer" to Treasury's expertise in currency matters, but it also made clear that it will not delegate to Treasury the ultimate determination of whether currency undervaluation constitutes a countervailable subsidy in a particular case. Thus, the regulations allow Commerce to impose countervailing duties on goods from countries accused of undervaluing their currencies even in cases where Treasury has determined that the relevant countries do not manipulate their currency. (Notably, China has recently been removed from Treasury's list of currency manipulators.)

Uncertainties Remain. Although the final regulations add detail to the approach Commerce set out in its proposed regulations, the final rules still leave much uncertainty as to what will be considered actionable. The regulations qualify all significant criteria by stating what Commerce will "normally" do, thereby leaving Commerce with a great deal of discretion. Indeed, Commerce notes in its preamble that "{t}he scope of government action under this final rule will necessarily become more clear as Commerce considers a range of government actions over time and the institutional settings in which they are undertaken. This could potentially include whether and how meaningful distinctions can be made between government action and market action." This lack of clarity could create significant risk for foreign companies seeking to trade with the United States as well as for U.S. importers.

If you have questions about this rule, please contact one of the experienced attorneys in Hughes Hubbard's International Trade practice.

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