U.S.-China "Phase One" Trade Deal

Tariffs on Chinese imports remain substantially unchanged; China commits to meeting trade obligations and importing more U.S. goods, but not to major structural reforms

January 17, 2020

International Trade, Public Policy

On January 15, 2020, President Trump and Chinese Vice Premier Liu He signed the much-anticipated “Phase One” trade agreement between the U.S. and China. Set to take effect no later than February 14, 2020, the “Economic and Trade Agreement Between the United States of America and the People’s Republic of China” (the “Agreement”) is the first formal accord concluded between the U.S. and China since the U.S. began imposing tariffs on Chinese imports in July 2018 and China responded in kind, triggering protracted negotiations buffeted by additional rounds of tariffs. In this respect, the Agreement signals a potential easing of trade tensions and renewed confidence in the bilateral economic relationship. The tariff landscape, however, will likely stay intact in the near-term future, and the Agreement may not ameliorate core U.S. concerns about China’s problematic intellectual property practices and China’s state-led economic development model. It remains to be seen how new obligations will be interpreted and enforced, and how the parties’ subsequent negotiations will evolve.

Overview of the Agreement

The Agreement consists of six substantive chapters covering intellectual property rights (Chapter 1), technology transfer (Chapter 2), food and agricultural products (Chapter 3), financial services (Chapter 4), exchange rate matters and transparency (Chapter 5), and expanding trade (Chapter 6). Additionally, the parties agreed to bilateral evaluation and dispute resolution procedures (Chapter 7). Other areas that had been under discussion, including structural issues related to China’s regulatory and industrial policies, are expected to be the subject of subsequent “Phase Two” negotiations.

The Agreement will enter into force within 30 days of signing (i.e. February 14, 2020), or once the U.S. and China have notified each other that they have implemented “applicable domestic procedures,” whichever is earlier.[1] Either party may unilaterally terminate the Agreement upon giving written notice to the other.[2] A unique transparency feature is that each party must provide at least 45 days for public comment on any proposed measures that implement the Agreement, and each party “shall consider concerns” raised by the other party, though the

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[1] Art. 8.3(1).
[2] Art. 8.3(2).

manner by which such consideration is afforded is not specified.[3] This provision, however, does not apply to proposed or final measures relating to the Agriculture Chapter.[4]

Impact on Tariffs

The talks that yielded the Agreement were precipitated in part by several rounds of escalating tariffs affecting imports from China that the U.S. has imposed starting in mid-2018 under Section 301 of the Trade Act of 1974, along with retaliatory Chinese tariffs. Companies whose supply chains have been disrupted may be disappointed to learn that the Agreement does not directly address these tariffs at all, let alone outline a plan for their removal. With the exception of a rate reduction on the newest set of Section 301 duties announced separately by the U.S., the tariff landscape is expected to remain largely intact for now.

The Section 301 tariffs are based on the U.S. Administration's determination in its March 2018 Section 301 Report that China's technology transfer and intellectual property ("IP") policies are harming U.S. companies. The current tariffs on Chinese imports have been implemented through four tariff lists, as follows:

- List 1: 25 percent tariffs on $34 billion in Chinese imports took effect on July 6, 2018; the Administration has granted certain product-specific exclusions.
- List 2: 25 percent tariffs on $16 billion in Chinese imports took effect on August 23, 2018; the Administration has granted certain product-specific exclusions.
- List 3: 10 percent tariffs on $200 billion in Chinese imports were initially imposed on September 24, 2018, though this rate increased on May 10, 2019, to 25 percent after the Administration cited "lack of progress" in negotiations and concerns that China had backtracked from earlier commitments.
- List 4A: 15 percent tariffs on approximately $120 billion in Chinese imports took effect on September 1, 2019. (The United States has already suspended the imposition of additional List 4B tariffs of 15 percent on nearly $160 billion of Chinese imports that had been due to take effect on December 15, 2019; major consumer products such as laptops, cell phones, and video game consoles had been included on this list. China reciprocated and suspended its December 15 slate of tariffs.)

In light of the deal, the United States has agreed to reduce the List 4A tariffs from 15 to 7.5 percent, effective February 14, 2020. The 25 percent tariffs on approximately $250 billion of Chinese imports (Lists 1-3) will remain in place. There is no mention of the U.S. tariff cuts in the text of the deal. The Agreement similarly does not include a commitment from China to reduce its retaliatory tariffs on U.S. goods, though tariff reductions or exemptions are understood to be necessary for China to implement its commitments to substantially increase its purchases of U.S. goods.

Intellectual Property

The Agreement's IP Chapter aims to address wide-ranging concerns about trade secrets (Article 1.3–1.9), pharmaceutical-related IP (Article 1.10–1.12), geographical indications (Article

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[3] Art. 8.5.
[4] Ch. 3 n.1.

1.15–1.17), trademarks (Article 1.24–1.25), and enforcement against pirated and counterfeit goods (Article 1.13–1.14, 1.18–1.23). Below, we analyze commitments regarding trade secrets, pharmaceutical IP, and trademarks and counterfeits. (See USTR's IP Chapter fact sheet)

Trade Secrets

Although the IP Chapter requires China to expand protections against trade secret theft, recent Chinese legislation had largely already implemented these additional protections. The IP Chapter requires China to "enumerate additional acts constituting trade secret misappropriation," including "electronic intrusions" and the "breach or inducement of a breach of duty not to disclose" trade secrets.[5] This more detailed definition of "misappropriation" marks an advancement beyond the recently concluded U.S.-Mexico-Canada Agreement, whose definition turns on whether a trade secret was acquired "in a manner contrary to honest commercial practices."[6] The IP Chapter also requires China to lower evidentiary burdens for plaintiffs seeking redress for trade secret misappropriation in civil actions,[7] to deem trade secret misappropriation an "urgent situation" for which preliminary injunctions are available,[8] and to lower barriers to initiating criminal proceedings.[9] These changes, however, were largely addressed through the April 2019 enactment of the Anti-Unfair Competition Law.[10] Accordingly, against this backdrop, the Agreement's practical impact on trade secret protection in China appears limited, though the Chinese legislation arguably was catalyzed by trade talks.

Although the Section 301 Report detailed U.S. concerns about Chinese cyber-theft of IP, the IP Chapter does not expressly reference the cyber-theft of trade secrets (or other IP) by Chinese state-supported actors, though this issue is expected to be taken up during Phase Two talks (see below).[11] The commitment that "all natural or legal persons can be subject to liability" for trade secret theft,[12] however, could be read to encompass actors working in concert with, or at the direction of, the government.

Patents and Pharmaceutical-Related IP

The IP Chapter potentially strengthens China's pharmaceutical-related patent and IP protections in various ways, building on reforms that have already been proposed in China. The primary reforms are patent related, although Section C indicates that China will also protect "undisclosed test or other data" that is "submitted as a condition of marketing approval." This reference to regulatory data protection (also known as "data exclusivity") is not expanded upon

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5 Art. 1.4(2).

6 USMCA, Art. 20.69. The USMCA text, in turn, parallels Article 39 of the WTO's TRIPS agreement, the first multilateral agreement to impose commitments governing the protection of undisclosed information.

7 Art. 1.5.

8 Art. 1.6(2).

9 Art. 1.7.

10 See Anti-Unfair Competition Law, Art. 6 (enumerating "urgent situations"), Art. 9(1)–(4) (defining the scope of trade secret misappropriation), Art. 32 (providing for burden-shifting in civil proceedings). Further legislative action is needed to implement the lower threshold for criminal liability.

11 Section 301 Report at 154–71.

12 Art. 1.3(1). See also Art. 1.3(2) (requiring China to define "operators" in trade secret misappropriation to include "all natural persons, groups of persons, and legal persons").

elsewhere in the Agreement, although the USTR fact sheet released with the Agreement states that the parties agreed to address data protection for pharmaceuticals in future negotiations.

With respect to the patent-related reforms, the Agreement addresses several issues. First, pharmaceutical patent applicants shall be permitted to use "supplemental data" to meet patentability requirements during judicial and administrative proceedings, thereby helping to ensure that the application receives full and fair consideration and that the filing of patent applications does not need to be delayed until all data has been collected.[13] This has been an issue that has caused problems for innovators in China for several years, with predecessors of China's National Intellectual Property Administration refusing to accept submissions of supplemental data during a drug product's research and development process. China amended its Patent Examination Guidelines to try to resolve this issue in 2017.

Second, China commits to establishing a system for early resolution of patent disputes, whereby patent holders, licensees, and marketing authorization holders can seek "expeditious remedies," such as preliminary injunctions, prior to the marketing approval of an allegedly infringing follow-on product.[14] The Agreement adopts elements common to the U.S. system of patent linkage: notice to the patent holder, licensee, or marketing authorization holder of the potentially infringing application; time for that rights holder to seek remedies to prevent the marketing of the allegedly infringing product; and access to judicial proceedings to resolve such patent disputes. The Agreement provides that these requirements apply to both small molecule drugs and biologics, and covers product and method of use patents. It does not appear to cover manufacturing process patents, which may be more important for biologics. The Agreement also does not explicitly mention a stay of marketing approval of the allegedly infringing follow-on product, a key feature of the U.S.'s patent linkage system. China committed in various policy documents in 2017 and 2019 to adopt a patent linkage system, similar to that in the U.S. and South Korea, but has not made significant progress in adopting legislation to implement it.

Lastly, China must permit patent term extensions to compensate for "unreasonable delays" in granting the patent (known as patent term adjustment) or "unreasonable curtailment of the effective patent term" resulting from the marketing approval process for pharmaceutical products (known as patent term restoration).[15] China committed in a high-level policy document in 2017 to restore patent life lost during development and marketing approval, and included a provision to implement such a program in a draft of the Patent Law from 2019.[16] The text of the Agreement closely mirrors the proposed provision in the Patent Law in that it will compensate

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[13] Art. 1.10(1). This commitment builds upon reforms in recent years that facilitated the use of supplemental data. See PhRMA 2019 NTE Comment at 84 ("In late 2016, CNIPA issued an amendment to its Patent Examination Guidelines that would require examiners to examine the post-filing experimental data submitted by the applicant. This amendment appears to be intended to implement China's commitment, made during the 2013 JCCT, to permit patent applicants to file additional data after the application filing date. PhRMA recognizes and welcomes this positive step, and is committed to working collaboratively with the appropriate government authorities to facilitate practical implementation of the proposed amendment in a manner that provides greater certainty and protection for U.S. biopharmaceutical innovators.").

[14] Art. 1.11.

[15] Art. 1.12.

[16] Opinion on Deepening the Reform of the Review and Approval System and Encouraging the Innovation of Drugs and Medical Devices (2017).

for “unreasonable” delays in the marketing approval process, granting up to a five year extension with no more than 14 years of effective patent term from the time of marketing approval.

Piracy and Counterfeiting on E-Commerce Platforms

The IP Chapter contains obligations directed specifically at infringement on e-commerce platforms, requiring China to, among other things, “require expeditious takedowns” by e-commerce platforms, “eliminate liability for erroneous takedown notices submitted in good faith,” and give rights holders more time (20 working days) to seek judicial or administrative relief after a “counter-notification.”[17] E-commerce platforms may be stripped of their operating licenses for “repeated failures to curb the sale of counterfeit or pirated goods.”[18]

Manufacture and Export of Pirated and Counterfeit Goods

China committed to enhance enforcement actions against counterfeit medicines and counterfeit goods posing health and safety risks,[19] broaden authority to destroy counterfeit goods,[20] and bolster enforcement at the border and at physical markets.[21] The parties also committed to ensuring that all government entities “install and use only licensed software,” with China’s commitment being subject to annual audits by independent third parties, whose results will be published online.[22]

Bad-Faith Trademarks

The IP Chapter contains a one-line obligation that the parties “shall ensure adequate and effective” trademark protection and enforcement, “particularly against bad faith trademark registrations.” There is no provision clarifying how a party shall determine what constitutes a “bad faith” registration.

The IP Chapter also seeks to strengthen judicial IP enforcement in China. Chinese administrative authorities must transfer a case for criminal enforcement when there is a “reasonable suspicion” of a criminal violation based on “articulable facts” and “under an objective standard.”[23] In order to enhance deterrence, China must also apply heavier penalties “at or near the statutory maximum” and, as a “subsequent step,” revise upward its minimum and maximum damages, fines, and criminal sentences.[24] Within a month after the Agreement takes effect, China must publish “work guidelines and implementation plans” that “ensure expeditious enforcement of judgments.”[25] Other obligations streamline the process of authenticating

[17] Art. 1.13(2).
[18] Art. 1.14(2).
[19] Art. 1.18, 1.19.
[20] Art. 1.20
[21] Art. 1.21, 1.22. China committed to “significantly increase” the number of enforcement actions and to publish online quarterly updates.
[22] Art. 1.23.
[23] Art. 1.26(1).
[24] Art. 1.27(2).
[25] Art. 1.28(2).

evidence in civil cases,[26] and guarantee an opportunity to present and cross-examine witnesses.[27]

The IP Chapter's implementation section strikes a balance between mandating follow-up action from China and respecting concerns about sovereignty and legislative authority.[28] In terms of required action, China must issue an "Action Plan" within 30 working days after the Agreement's entry into force.[29] The Action Plan must identify "measures that China will take to implement its obligations" and dates by which each measure will take effect.[30] On the other hand, China retains discretion to "determine the appropriate method of implementing the provisions of this Agreement within its own system and practice."[31] Legislative changes are not mandated, though "[i]f necessary," China "shall provide suggestions for the amendment of laws to its legislative body according to its domestic legislation procedure."[32]

Technology Transfer

Chinese practices of promoting or condoning forced technology transfer were one of the main areas of concern identified in the Section 301 Report[33] and were cited as an initial basis for imposing Section 301 tariffs.[34] Although the inclusion of disciplines on technology transfer marks a breakthrough for enforceable trade agreements, the Agreement's technology transfer obligations are framed at a fairly high level and may be difficult to enforce. (See USTR's Technology Transfer Chapter fact sheet)

The Technology Transfer Chapter's "General Obligations" section outlines several core disciplines. Companies must be free to operate in and access the market of the other party "without any force or pressure from the other Party to transfer their technology to persons of the other Party."[35] More specifically, technology transfers or licensing between U.S. and Chinese entities "must be based on market terms that are voluntary and reflect mutual agreement."[36] Additionally, neither party shall "support or direct the outbound foreign direct investment activities of its persons aimed at acquiring foreign technology with respect to sectors and industries targeted by its industrial plans that create distortion."[37] These obligations raise several

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[26] Art. 1.30(1)-(2).
[27] Art. 1.31(1).
[28] The U.S. has no compliance obligations under the IP Chapter, as it "affirms that its existing measures" are compliant. Art. 1.36.
[29] Art. 1.35. Our sources indicate that China may be working under an understanding that this is a 30 "calendar day" target.
[30] Art. 1.35.
[31] Art. 1.34.
[32] Art. 1.34.
[33] Section 301 Report, at 19 ("China uses inbound foreign ownership restrictions, such as joint venture (JV) requirements and foreign equity limitations, and the administrative licensing and approvals process to require or pressure the transfer of technology.").
[34] *Notice of Determination and Request for Public Comment Concerning Proposed Determination of Action Pursuant to Section 301: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation*, 83 Fed. Reg. 14906, 14906–07 (Apr. 6, 2018).
[35] Art. 2.1(1).
[36] Art. 2.1(2).
[37] Art. 2.1(3). This particular provision appears to be worded more precisely in the Chinese text: "A Party shall not support or direct its persons to engage, with respect to sectors and industries targeted by its

questions. For instance, “force or pressure” is not defined; nor is the nature of “market terms” and “mutual agreement.”[38] Regarding the outbound investment discipline, the U.S. and China would likely disagree as to whether “industrial plans that create distortion” include Chinese industrial policies such as Made in China 2025,[39] and in specific instances, whether a transaction was “support[ed] or direct[ed]” by the government.

In subsequent provisions, the Technology Transfer Chapter applies the prohibition against “requir[ing] or pressur[ing]” persons to transfer technology to more specific contexts—acquisitions, joint ventures, and investments,[40] along with administrative and licensing requirements and processes.[41] In particular, as part of administrative and licensing processes, technology transfer cannot be made a “condition” for approvals, market access, or “receiving or continuing to receive any advantages” provided by a party.[42] One discipline arguably ventures beyond the Chapter’s focus on technology transfer, prohibiting requiring or pressuring a person of the other party “to use or favor technology that is owned by or licensed to its persons” as a condition for approvals, market access, or “receiving or continuing to receive any advantages” provided by a party.[43] Remaining obligations aim, among other things, to promote transparency,[44] and to limit requirements to disclose sensitive technical information to only what is needed by authorities.[45]

The Technology Transfer Chapter closes with obligations related to due process and transparency, which apply generally to administrative proceedings—apparently not limited to those relating to technology transfer. Persons must have notice regarding basic procedural features of “administrative proceedings related to the subject matter of this Agreement,” including applicable laws and regulations, rules of evidence, and remedies. Additionally, persons must be afforded due process and the right to review evidence and retain counsel in “administrative proceedings against them.”[46] These disciplines do not appear to be linked exclusively to technology transfer, and the scope of proceedings “related to the subject matter of this Agreement” is unclear, but arguably could include IP enforcement actions, license application proceedings, or foreign investment market access filings and approval proceedings.

Trade in Food and Agricultural Products

To promote exports of U.S. food, agricultural, and seafood products to China, the Agriculture Chapter primarily addresses structural barriers to trade, such as non-tariff barriers and tariff-rate

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industrial plans, in outbound foreign direct investment activities that aim to acquire foreign technology and that create distortion.” (一方不得支持或指导其个人针对其产业规划所指向的领域和行业，开展以获取外国技术为目的、导致扭曲的境外直接投资活动。) That both the English and Chinese versions are “equally authentic” may give rise to an interpretive dispute. *See* Art. 8.6.

[38] Contrast this with the detailed discussion of problematic practices in the Section 301 Report. *See* Section 301 Report, at 19–61.

[39] Section 301 Report, at 10 (discussing Made in China 2025 Policy).

[40] Art. 2.2.

[41] Art. 2.3(1).

[42] Art. 2.3(2).

[43] Art. 2.3(3).

[44] Art. 2.3(4).

[45] Art. 2.3(5).

[46] Art. 2.4(3).

quotas. It contains 17 annexes covering a range of product areas and regulatory spaces.[47] The Agriculture Chapter also contains an appendix with a list of meat products that are not eligible for import into China, ranging from mechanically separated beef to feathers and tails of poultry.[48] (See USTR's Agriculture and Seafood Related Provisions Chapter fact sheet)

Given the range of topics covered in the Agriculture Chapter, it is important for companies to determine whether they could benefit from the elimination of one of these barriers. For example, under the Agreement, the U.S. has greater access to the Chinese dairy market because China will now allow importation of products manufactured at facilities designated by the U.S. Food and Drug Administration that have received an Agricultural Marketing Service certificate.[49] There are also special provisions affecting shelf life milk, fortified milk, ultrafiltered fluid milk, dairy permeate powder, and infant formula.[50] Similarly, China agreed to import most U.S. beef that has been inspected by the U.S. Department of Agriculture at an approved Food Safety and Inspection Service facility.[51] The Agriculture Chapter also contains a provision on agriculture biotechnology, through which China agreed to "implement a transparent, predictable, efficient, science- and risk-based regulatory process for safety evaluation and authorization of products of agricultural biotechnology."[52] This provision is designed to address the problem faced by U.S. farmers whereby "product approvals languish in China's regulatory system for five to seven years," by requiring China to complete reviews of applications for biotechnology products related to feed or further processing in no more than 24 months.[53] In two side letters to the Agreement, China approved for import lists of 23 feed products and 26 species of seafood.

The Agriculture Chapter leaves open important questions relating to approval of new pesticide products in China, China's treatment of unapproved biotech traits that has affected U.S. corn farmers, and China's ban on U.S. meat containing ractopamine.

Financial Services

The Financial Services Chapter addresses numerous long-standing barriers that U.S. financial companies face in the Chinese market, in sectors including banking (Article 4.2), credit rating services (Article 4.3), electronic payment (Article 4.4), distressed debt services (Article 4.5); insurance (Article 4.6), and securities, fund management, and futures (Article 4.7). These commitments build on previous financial sector liberalization announcements by China in 2018 and 2019 and previous bilateral commitments negotiated with the United States in 2017 and 2015. (See USTR's Financial Services Chapter fact sheet)

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[47] Ch. 3,, Annexes 1-17. The annexes cover agricultural cooperation; dairy and infant formulas; meat, including beef, pork, and poultry, and live breeding cattle; aquatic products; rice; plant health; feed additives, premixes, compound feed, distillers' dried grains, and distillers' dried grains with solubles; pet food and non-ruminant derived animal feed; tariff rate quotas by China for wheat, rice, and corn; transparency surrounding China's publication of laws and regulations relating to domestic support measures; agricultural biotechnology; and food safety.
[48] Ch. 3, Appx. I.
[49] Ch. 3, Annex 2(2).
[50] Ch. 3, Annex 2(2)-(3).
[51] Ch. 3, Annex 4(4).
[52] Ch. 3, Annex 16(2).
[53] Ch. 3, Annex 16(2).

The Chapter includes a number of Chinese commitments to improving market access. In particular, China commits to: remove foreign equity caps on certain financial services providers by April 1, 2020, such as securities, fund management, and futures companies[54] and U.S. suppliers of life, pension, and health insurance services[55]; expeditiously review and approve any pending license applications of U.S. credit rating services suppliers (by May 14, 2020)[56]; and allow subsidiaries of U.S. financial institutions to provide securities investment fund custody services (by July 14, 2020),[57] while taking into account their (or their parent company's) overseas assets to satisfy applicable asset requirements.[58] For electronic payments, China agrees to ensure an improved and expeditious licensing process for U.S. electronic payment services providers.[59] China also commits to take into account U.S. financial institutions' international qualifications when evaluating applications to serve as Type-A lead underwriters for any types of non-financial debt instruments.[60]

China also commits to remove discriminatory regulatory requirements and processes in the insurance services sector[61] and to ensure that U.S. securities, fund management, and futures companies can access China's market on a non-discriminatory basis.[62] China further commits to ensure that any new national licenses for financial asset management companies would be granted on a non-discriminatory basis.[63]

Macroeconomic Policies and Exchange Rate Matters and Transparency

The Agreement's Currency Chapter begins by requiring each party to respect the other's "autonomy in monetary policy, in accordance with its domestic law."[64] At the same time, the Currency Chapter recommits the parties "to honor currency-related commitments each has undertaken in G20 communiqués."[65] It covers exchange rate practices, transparency, and enforcement. (See USTR's Macroeconomic Policies and Exchange Rate Chapter fact sheet)

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[54] Art. 4.7. China's CSRC announced on October 11, 2019 that it would remove the foreign equity cap on securities companies on December 1, 2020, fund management companies on April 1, 2020, and futures companies on January 1, 2020. So the Agreement accelerates the timeline for eliminating the equity cap on securities companies.
[55] Art. 4.6(1). China has removed these foreign equity caps as of January 1, 2020, according to a notice of China Banking and Insurance Regulatory Commission (CBIRC) issued on December 6, 2019. The Administrative Regulation of Foreign Invested Insurance Companies was also recently amended on September 30, 2019, which has eliminated the requirement that a foreign investor establishing an insurance company in China shall have 30 years of insurance operation experience.
[56] Art. 4.3(1).
[57] Art. 4.2(2).
[58] Art. 4.2(2). This commitment was addressed in a speech of the Chairman of the China Securities Regulatory Commission (CSRC) on June 13, 2019, and CSRC has issued a license to Standard Chartered by taking into account its overseas assets.
[59] Art. 4.4.
[60] Art. 4.2(3).
[61] Art. 4.6(2).
[62] Art. 4.7.
[63] Art. 4.5.
[64] Art. 5.1(1).
[65] Art. 5.1(4).

Most significantly, the parties agreed to refrain from engaging in competitive devaluations and targeting exchange rates for competitive purposes, such as "through large-scale, persistent, one-sided intervention in exchange markets."[66] The Agreement encourages the parties to employ an exchange rate policy that is market-determined and "strengthen underlying economic fundamentals" to promote exchange rate stability.[67] The Currency Chapter, however, does not elaborate on which actions constitute the strengthening of underlying economic fundamentals. To enhance transparency, the Currency Chapter contains a number of provisions to continue disclosure obligations previously undertaken by each party, including disclosure of monthly foreign exchange reserves data and forward positions, certain quarterly balance of payments, quarterly exports and imports of goods and services, as well as guaranteeing public disclosure of particular, exchange rate-related information by the International Monetary Fund ("IMF").[68] Finally, the parties agreed to an enforcement provision, whereby they can seek enforcement through the Dispute Settlement Chapter of the Agreement (discussed below) for "[i]ssues related to exchange rate policy or transparency."[69] Moreover, if that process does not result in a mutual resolution, a complaining party can seek IMF involvement in the form of "rigorous surveillance" or formal consultations.[70] In the United States, the authority to seek enforcement is delegated to the Treasury Secretary.

According to USTR, the Currency Chapter will "ensure that China cannot use currency practices to unfairly compete against U.S. exporters." Relatedly, on January 13, the Treasury Department removed its designation of China as a currency manipulator just five months after initially adding China to that list. In this decision, the Treasury cited as a key factor China's commitment to enter into enforceable obligations through the Phase One deal. However, the Agreement appears to impose no significant new obligations on China, given that China had already agreed to many of these provisions in the G20 and as a function of its membership in the IMF. The enforcement mechanism, however, could provide some relief where the U.S. government is willing to utilize that tool. In addition, although the Agreement largely tracks the currency chapter in the U.S.-Mexico-Canada Agreement, it leaves out monthly publication requirements related to interventions in spot and forward exchange markets.

Expanding Trade

The Expanding Trade Chapter memorializes China's commitment that, during the two-year period between January 1, 2020 and December 31, 2021, its total imports of certain goods and services from the United States exceed the corresponding amounts imported in 2017 by no less than $200 billion. This chapter establishes the baselines for four categories of imports — i.e., manufactured goods, agricultural products, energy products, and services — and provides a list of particular goods and services that are covered. (See USTR's Expanding Trade Chapter fact sheet)

1. China agreed to increase its purchases and imports of U.S. manufactured goods (which include, among other things, industrial machinery, electrical equipment, pharmaceutical products, aircraft, vehicles, optical and medical instruments, iron and steel, solar-grade

66 Art. 5.2(3).
67 Art. 5.2(2).
68 Art. 5.3.
69 Art. 5.4(1).
70 Art. 5.4(2).

polysilicon, hardwood lumber, and chemical products) by at least $32.9 billion compared to the 2017 baseline in 2020, and by at least $44.8 billion compared to the 2017 baseline in 2021.

2. For certain U.S. agricultural products (which include, among other things, soybeans, cotton, grains, meats, ethanol, seafood), China's imports will be at least $12.5 billion higher than the 2017 baseline in 2020 and at least $19.5 billion higher than the 2017 baseline in 2021.
3. China will also increase its purchases and imports of U.S. energy products (which include, among other things, liquefied natural gas, crude oil, and metallurgical coal) by at least $18.5 billion compared to the 2017 baseline in 2020 and by at least $33.9 billion compared to the 2017 baseline in 2021.
4. Lastly, China will increase its purchases and imports of U.S. services (which include, among other things, financial services, insurance services, cloud services, and travel services) by at least $12.8 billion compared to the 2017 baseline in 2020 and by at least $25.1 billion compared to the 2017 baseline in 2021.

The parties agree to use official data of both parties to determine whether this chapter has been implemented. If, however, the parties' respective trade data gives rise to conflicting conclusions on whether the chapter has been implemented, the parties can engage in consultations.[71]

China can also request consultations with the United States where its ability to fulfill its obligations is affected by an action or inaction by the United States or by other circumstances arising in the United States.[72]

The methodology prescribed by the Expanding Trade Chapter for valuating financial, services, insurance, and cloud services permits inclusion of the value of services provided both on a cross border basis and through a commercial presence in China.[73] In the financial services and insurance sectors, the Chinese government has announced major policy and regulatory reforms to enable U.S. providers to access the Chinese market through establishing a commercial presence. It is uncertain whether the Expanding Trade Chapter foreshadows changes in China's regulatory framework for cloud and related services, potentially enabling foreign service providers to establish a commercial presence in China and obtain necessary licenses to offer such services.[74]

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[71] Art. 6.2(6).

[72] Art. 6.2(7).

[73] The calculation of the value for purchases and imports of services listed in Annex 6.1 is based on revenue derived from services supplied on a cross border basis (Mode 1), with the exception of the numbers for financial services and insurance and cloud service. For those excepted categories, the value of these services purchased or imported by China includes services supplied both on a cross border basis (Mode 1) and through commercial presence in China (Mode 3), as evidenced by footnote f of Annex 6.1.

[74] Under China's current regulatory framework for value added telecom services (VATS), cloud computing services are categorized as "Internet Resources Collaboration Business" (B 11), and an operator must obtain a VATS license to be able to offer such services. At the moment, major foreign cloud service providers are not able to obtain such a license, and are therefore unable to provide such services through their commercial presence in China. Consequently, it remains unclear how the Chinese government plans

Some commentators have flagged potential tension between these purchase commitments and China's obligations under the rules of the World Trade Organization ("WTO"), to the extent that this Chapter is implemented as a binding restriction on trade flows. Notably, however, the parties stress in the "Objectives" section of this Chapter that the implementation of the Agreement "should lead to" better trade flows, "including significant increases in exports . . . to China" from other countries as well as the U.S., a statement consistent with the parties' view that the Agreement is WTO-compliant.[75]

Bilateral Evaluation and Dispute Resolution

The Agreement establishes an enforcement mechanism that was highly-touted by the administration. The Agreement creates: (1) a Trade Framework Group, led by the U.S. Trade Representative and a Vice Premier from China, for continued high-level engagement between the parties to address issues related to overall implementation of the Agreement and economic issues,[76] and (2) a Bilateral Evaluation and Dispute Resolution Office for each country, led by a Deputy U.S. Trade Representative and a Vice Minister from China, to deal with disputes through consultations as well as discuss "future work between the Parties," which could include topics beyond those related to implementation of the current agreement.[77] The Trade Framework Group will meet every six months, and the heads of the Bilateral Evaluation and Dispute Resolution will meet quarterly, along with monthly meetings by designated officials of each party, thereby opening a consistent and scheduled dialogue between the parties.[78] The Dispute Settlement Chapter also calls for regular macroeconomic meetings between the U.S. Treasury Secretary and a Chinese Vice Premier, thus reinstating another channel for bilateral dialogue.

At any time, a party may request information or a meeting with the other party, and the responding party has 15 days to respond to requests for information.[79] Where a dispute arises, the U.S. or China may complain by filing an appeal with the responding party's Bilateral Evaluation and Dispute Resolution Office, which will then assess the appeal within 10 days, and then can initiate consultations.[80] If there is no resolution after several rounds of escalating consultations, the Dispute Settlement Chapter allows the complaining party to unilaterally enforce the Agreement by "taking action based on facts provided during the consultations, including by suspending an obligation under this Agreement or by adopting a remedial measure in a proportionate way that it considers appropriate."[81] The Dispute Settlement Chapter contemplates that a party may take remedial actions within 96 days of the initial complaint.[82] So long as the responding party believes the unilateral action was taken "in good faith," it cannot retaliate.[83] But, where the responding party believes the action was taken "in bad faith," its only

to fulfill its commitment to increase the purchase and import of cloud services under the Expanding Trade Chapter, particularly if U.S. cloud service providers are unable to provide services through a commercial presence under the current VATS regulatory framework.

[75] Art. 6.1(1); see also Art. 7.6(1) ("The Parties affirm their existing rights and obligations with respect to each other under the WTO Agreement and other agreements to which the Parties are party.").

[76] Art. 7.2(1).

[77] Art. 7.2(2).

[78] Ch. 7, Annex 7-A(1), (3).

[79] Art. 7.3; Ch. 7, Annex 7-A.

[80] Art. 7.4(1), (3); Ch. 7, Annex 7-A.

[81] Art. 7.4(4)(b).

[82] Art. 7.4(4)(b); Ch. 7, Annex 7-A.

[83] Art. 7.4(4)(b).

remedy is to "withdraw from this Agreement" by giving written notice.[84] In addition to the escalating consultations, where a party considers "an implementation issue is a matter of urgency," they can directly raise the issue at a meeting between the U.S. Trade Representative and the Vice Premier.[85] If such a meeting cannot be timely scheduled, then the complaining party can unilaterally take remedial action.[86]

This dispute settlement process requires action by the government of each party, and does not expressly contemplate a mechanism for companies affected by a violation of the Agreement to seek dispute settlement. Nonetheless, companies seeking redress may appeal to their respective governments and request that the governments pursue resolution through the Trade Framework Group or formal dispute settlement before the Bilateral Evaluation and Dispute Resolution Office. As with any state-to-state dispute settlement mechanism, convincing a government to pursue that approach can be a challenging process. The scheduled dialogue between the parties, on the other hand, offers a unique opportunity for companies to provide information to the U.S. Trade Representative and Treasury before those agencies meet with their Chinese counterparts. Furthermore, the Dispute Settlement Chapter does not affect a U.S. company's ability to employ the traditional trade remedy tools available to it under U.S. law.

Prospects and Expected Agenda for Phase Two Negotiations

The successive rounds of negotiations that began a year ago covered many issues that were not included in the Phase One agreement, or addressed only partially. These unresolved issues will form the basis for the next phase of negotiations to reach a Phase Two agreement. They touch on structural features of China's regulatory regime and industrial policies that are fundamental to China's economic model, and on issues that are particularly sensitive for national security or political reasons. These include industrial subsidies, innovation policy, cyber theft of intellectual property, government procurement, competition policy, digital trade and cross-border data transfer, policies related to cultural industries, and cybersecurity requirements.

The Phase One agreement anticipates this agenda in some respects. For example, the preamble to the Technology Transfer chapter states that "establish[ing] a foundation for addressing long-standing structural concerns" is one of the purposes of this relatively short chapter of the Agreement.[87] These issues will prove much more difficult to resolve than those addressed in Phase One. Treasury Secretary Steven Mnuchin stated that "Phase Two may be 2a, 2b, 2c, we'll see," implying that the Administration could adopt an incremental approach to reach another partial agreement in the near term, which would result in the removal of some additional U.S. tariffs but not all. President Trump said that the existing $360 billion in additional U.S. tariffs (Lists 1, 2, 3, and 4A) would be removed once all of the remaining issues are resolved, which is very unlikely to occur before the end of his current administration.

The Phase One agreement is silent as to substance or process for this next phase, stating only that the parties will agree separately on timing.[88] Negotiations on Phase Two will not likely begin

[84] Art. 7.4(4)(b).
[85] Art. 7.5.
[86] Art. 7.5.
[87] Ch. 2, Preamble.
[88] Art. 8.4.

until after Phase One takes effect on February 14. China will begin preparing in late February for its annual legislative meetings held in early March. Moreover, much of the energy and attention of both sides is likely to be focused on implementation of Phase One in the next few months. Nevertheless, it is likely that the administration will want to demonstrate that it is making serious efforts to address the unresolved issues in Phase Two as the presidential election approaches. As with Phase One, while there is no formal process for consultation with industry, USTR and other agencies will likely be open to receiving input informally from companies and trade associations on issues under discussion in the negotiations.

Outlook for the Broader U.S.-China Economic Relationship

The main effect of the Phase One agreement on the bilateral relationship is to halt the escalation of the trade war, including averting the imposition of tariffs on $160 billion in Chinese goods, which would have substantially included consumer goods for the first time. It should provide a measure of stability in the business environment, at least as it relates to tariffs and retaliation. The U.S. and China have also agreed to return to regular communication through formal dialogues on trade and macroeconomic issues. However, this is a fairly fragile truce that will be tested in the Agreement's implementation and by a new model of dispute settlement that ultimately allows for unilateral enforcement. While both sides have an interest in seeing this agreement work, a return to escalation cannot be entirely ruled out if serious issues of compliance arise or the political calculus changes.

Moreover, this de-escalation on trade does not signal a truce on points of bilateral friction outside of trade, nor does it change the basic trajectory of the relationship, characterized by intensifying competition and at least partial decoupling from interdependencies in technology. The Phase One trade deal does not resolve the underlying differences between the two countries' economic systems, which will continue to fuel trade tensions. National security concerns on both sides and the growing geopolitical rivalry between the United States and China will likely continue to create new compliance risks for companies and threaten disruptions to supply chains and business relationships, particularly in the technology sector. For example, the U.S. Commerce Department is currently considering new rules that would significantly tighten existing restrictions on the export of U.S. technologies to Huawei. Pending U.S. legislation related to human rights or Taiwan, or new law enforcement actions and China's reactions to them, could also exacerbate frictions.

In addition to assessing how the Phase One agreement may impact their business strategies and operations, businesses should evaluate the specific risks and opportunities for their companies in different potential future scenarios as the resetting of the U.S.-China relationship -- of which trade is just one component -- continues to unfold.

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Covington's diverse trade policy teams in Washington and Beijing, which include former senior government officials, are uniquely positioned to provide thoughtful strategic advice to clients seeking to monitor, prepare for, and react to the evolving Section 301 developments. We count among our ranks:

- Chris Adams, former Senior Coordinator for China Affairs at the U.S. Department of Treasury and Minister Counselor for Trade Affairs at the U.S. Embassy, Beijing;
- Marney Cheek, former Associate General Counsel in the Office of the USTR;

- Alan Larson, former Under Secretary of State for Economic, Business and Agricultural Affairs;
- Timothy Stratford, former Assistant USTR for China Affairs; and
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