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Meyer Corp. v. United States: A Slippery Slope For U.S. Importers of Goods from Non-Market Economies?

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The U.S. Court of International Trade ("CIT") recently issued its decision in *Meyer Corp. v. United States*, questioning the applicability of the longstanding first sale for export ("FSFE") duties savings principle by a U.S. importer for goods and inputs produced in non-market economy ("NME") countries.[1] While U.S. Customs and Border Protection's ("CBP") interpretative application of *Meyer Corp.* is still to be determined, the decision offers up a unique perspective on the customs valuation risks of transacting business with NME countries such as China and Vietnam. If weaponized by CBP, the concerns raised by the CIT in *Meyer Corp.* may have unintended and ubiquitous consequences on the customs valuation of imported goods in general, beyond the application of FSFE.

This article discusses the CIT's decision in *Meyer Corp.* and how it may affect U.S. importers' duty mitigation planning, explores what importers (including those *not* claiming FSFE) should consider when transacting with suppliers in NME countries, and raises practical concerns should CBP go down the slippery slope suggested by the CIT.[2]

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1 Meyer Corp., U.S. v. United States, Court No. 13-00154, Slip Op. 21-26 (Ct. Int'l Trade 2021).

2 In addition to the issue of whether the transactions qualified for FSFE treatment, *Meyer* also considered whether the cookware sets qualified for preferential treatment under the Generalized System of Preferences. However, this article focuses only on the FSFE issue.

First Sale for Export

By way of background, FSFE was established in 1992 in the seminal court decision of *Nissho Iwai American Corp. v. United States*.[3] Since then, importers in the United States who import qualifying goods through multi-tiered supply chains have benefited from the FSFE *transaction valuation* principle to reduce the amount of duties owed to CBP.[4] For example, when a U.S. importer purchases and imports goods from a foreign middleman (for $100) who, in turn, purchased said goods from a foreign manufacturer (for $60), the goods may be valued on the basis of the lower "first sale," or FSFE, price between the foreign middleman and foreign manufacturer ($60 in the example) rather than on the higher price in the sale between the U.S. importer and foreign middleman ($100 in the example). This reduces the customs *transaction valuation* basis on which *ad valorem* duties are assessed, thereby reducing the importer's duty liability.

To qualify the FSFE price as the declared import value, the U.S. importer must establish that the claimed FSFE transaction is a *bona fide* sale, the goods are *clearly destined* for export to the United States, and the price paid to the foreign manufacturer by the middleman is at *arm's length*. The *Meyer* case focused on the *arm's length* requirement.

Meyer Corp. v. United States

The primary issue before the CIT was whether cookware sets purchased and imported into the United States from related parties in China and Thailand could be appraised based on the FSFE value. The CIT specifically reviewed and considered two transaction flows. The first flow involved a producer in Thailand, Meyer Industries Limited ("MIL") that sold the goods to a middleman in Macau, Meyer Marketing Co. Ltd ("MMC"); and the second flow involved a producer in China, Meyer Zhaoqing Metal Products Co. Ltd ("MZQ") that sold the goods to a middleman in Hong Kong, Meyer Manufacturing Company Limited ("MHK"). Meyer Corporation, U.S. ("Meyer") was the importer in both flows. All parties were "related" for U.S. customs purposes.

In each respective transactional flow, the Thai and Chinese producers sourced raw material inputs from a Chinese supplier. The proposed FSFE transaction in each flow was between the producer (either MIL or MZQ) and the middleman (either MMC or MHK, respectively).

In its decision, the CIT considered the supporting documentation, which included a transfer pricing study prepared by a third party, commercial documents, and limited financial information, but ultimately determined that the importer failed to establish that the FSFE price was not influenced by the relationship between the parties, as required by United States customs law (i.e., the importer did not satisfy the "circumstances of sale" requirements).

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[3] Nissho Iwai American Corp. v. United States, 982 F.2d 505 (Fed. Cir. 1992).

[4] *See Determining Transaction Value in Multi-Tiered Transactions,* Treasury Decision 96-87 (December 13, 1996).

Circumstances of Sale

In transactions between unrelated parties, the customs value of imported goods is presumed to be undertaken at arm's length. Between related parties, however, the seller's price must generally satisfy one of the "circumstances of sales" tests or "test values" to be considered arm's length. Meyer undertook both the "all costs plus a profit" ("ACPP") and "normal pricing practices of the industry" ("NPPI") tests to demonstrate that the relationship between the buyer and seller did not affect the price of the goods under the "circumstances of sales" test. However, the CIT found that the plaintiff's evidence and cooperation was inadequate to establish the sales occurred at arm's length, particularly in light of the novel concerns raised by the CIT concerning the potential market-distortive influences on the costs of the imported goods as a result of the transaction involving NME suppliers and/or inputs.

All Costs Plus a Profit

Under the customs regulations, one approach to demonstrate that an FSFE transaction between related parties occurred at arm's length is for the importer to establish that the seller's price "is adequate to ensure recovery of all costs plus a profit that is equivalent to the *firm's* overall profit realized over a representative period of time in sales of merchandise of the same class or kind."[5] CBP generally interprets the "firm" to mean the parent company of the importer.

During trial, the government argued, and the CIT agreed, that the ACPP was not satisfied because financial information for the importer's parent company, Meyer International Holdings ("MIH"), the overall holding company, was not provided, nor was financial information provided for any of the parties to the transaction. Furthermore, Meyer only provided cost and profit information for two products while the disputed transactions involved over 100 Thai products and 32 Chinese products. Thus, given the overall lack of financial transparency, the CIT was unpersuaded that the importer adequately demonstrated that the FSFE transactions occurred at arm's length pursuant to the ACPP test.

Normal Pricing Practices of the Industry

Another approach to establish an FSFE transaction is at arm's length is to demonstrate that "the price has been settled in a manner consistent with the normal pricing practices of the industry in question."[6] During trial, Meyer presented its benchmarking analysis of cookware companies for the 2010-2012 timeframe and observed that MIL's full-cost mark-up and operating profit margin was within the interquartile range of the comparable companies used to test MIL. Thus, Meyer argued that the prices were settled in a manner consistent with the industry. The CIT, however, adopted the government's position that the studies were deficient.

Among other issues, the CIT noted that the screening criteria for identifying comparable companies in both China and Thailand did not take into account whether they sold goods of the "same class or kind," the destination countries to which the cookware was sold, the volume of production, whether the database contained audited financials, or if the companies were publicly traded or privately held. Thus,

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[5] 19 C.F.R. § 152.103(l)(1)(iii) (emphasis added).

[6] 19 C.F.R. § 152.103(l)(1) (ii)

the CIT was also unpersuaded that the importer adequately demonstrated that the FSFE transactions occurred at arm's length pursuant to the NPPI test.

China's Non-Market Economy Status

Based on the CIT's recitation of facts and evidentiary concerns, the outcome regarding the ACPP and NPPI tests were not surprising. What raised eyebrows in the trade community was the CIT's suggestion that the "real" costs of goods and inputs produced in China were inherently "suspect" by virtue of the country's NME status.

The CIT doubted that the "true" value of the "price actually paid or payable" could be ascertained based on the evidence submitted. It also indicated that the parent company (MIH) presumptively had the ability to influence prices or booked profits through financial arrangements (e.g., access to credit or capital on favorable terms that are not available to competitors or below market rates). It did not help the importer's case that MIH did not produce financial statements that the court indicated could assuage these concerns and bolster the importer's argument that the relationship between the parties did not influence the price.

Nor could Meyer conclusively state that the Chinese entity did not receive subsidies from the local, regional, or national government. Specifically, the CIT pointed to testimony from the manager of the China producer that he was unaware as to whether the Chinese government provided subsidies either to the producer or the companies that provided production materials.

The CIT seemingly focused on the U.S. Court of Appeals for the Federal Circuit's ("CAFC") language in the seminal FSFE decision in *Nissho Iwai* to ground its skepticism:

> The manufacturer's price constitutes a viable transaction value when the goods are clearly destined for export to the United States and when the manufacturer and the middleman deal with each other at arm's length, *in the absence of any non-market influences that affect the legitimacy of the sales price*.[7]

The CIT latched on to the qualifying language concerning "non-market influences" and went as far as to broadly express "doubts over the extent to which, if any, the [FSFE] test of Nissho Iwai was intended to be applied to transactions involving non-market economy participants or inputs." A question the CIT rhetorically referred back to the CAFC to clarify.

The CIT went a step further by applying its skepticism even to goods produced in a market economy, noting that "Meyer must further establish the absence of any market-distortive influences on the price of the cookware, both for that manufactured in the PRC and for the Thai cookware *with components from China*." (Emphasis added). If adopted by CBP, the CIT's implication could potentially have far-reaching tentacles given the prominence that China plays in many supply chains.

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[7] Nissho Iwai American Corp. v. United States, 982 F.2d 505, 509 (Fed. Cir. 1992) (emphasis added).

Observations and Recommendations

While at first blush the CIT's focus on the potentially market-distortive effects NMEs have on related-party transactions may raise concerns about the future of FSFE, the decision does not alter the FSFE requirements generally, or with respect to goods or inputs from China specifically. This decision is specific to the plaintiff's facts and circumstances, colored by the plaintiff's apparent resistance to reasonable discovery requests, inconsistent facts, insufficient industry data and questionable expert testimony. Certainly, while the CIT's concerns about China's non-market economy status highlighted the importance of financial transparency to the case, the importer's "resistance" to produce key information and failure to provide critical documentation seemingly played into the CIT's concerns.

There are a number of compelling reasons to believe that the CIT's observations may not be as disruptive as it may initially appear. In terms of precedential authority, the court's doubts over whether FSFE was intended to be applied to transactions involving NME countries was dicta *(*i.e., non-binding opinions or observations of a judge that do not embody the resolution or determination of the specific case before the court.). Moreover, the potential presence of market-distortive influence by the Chinese government was an issue that the U.S. government "only lightly explored" at the agency level and during the litigation. This is an issue not typically inquired into by CBP in the nearly three decades that FSFE has been used and/or approved with respect to China suppliers. And this may be for good reason, as discussed further below.

It is unlikely the seminal *Nissho Iwai* decision that established the FSFE principle intended to create a blanket prohibition on FSFE in NME countries because that case did not involve participants in an NME country (the producer was a Japanese company). It is more likely that the CAFC's requisite "absence of any non-market influences that affect the legitimacy of the sales price" was intended to curb the kind of non-market influences that a parent company may potentially exert on an affiliated subsidiary to set prices in a manner that is not representative of how unrelated parties would in order to unduly garner a favorable tax or customs outcome. After all, the customs statute under which CBP obtains its authority to review the acceptability of related-party transactions under the *transaction value* method clearly directs CBP's enquiry to examine whether the "relationship between the buyer and the seller" influenced the price of imported goods, rather than influence of the foreign government.[8] Arguably, the CIT's concerns in *Meyer Corp.* pertain more directly to the relationship between the foreign government and the local supplier, and it influence on the cost of inputs, rather than the influence of the relationship between the buyer and seller in setting the price of finished goods. Thus, the nexus between the CIT's broad NME concerns and the customs valuation requirements may be tenuous at best, and/or may be out of scope under CBP's "related party" authority. Rather, it is generally within the U.S. Department of Commerce's purview, together with the International Trade Commission, to address non-market economy influences on the price of imported goods through the imposition of antidumping and countervailing duties. While CBP is tasked with collecting the duties, it is generally not responsible for identifying or remedying these types of market-distortive behaviors raised by the CIT in *Meyer Corp.*, nor are the customs valuation laws written with that policy objective in mind.

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[8] 19 U.S.C. § 1401a(b)(2)(B).

If CBP were to start presuming that related-party transactions involving suppliers in NME countries like China are inherently dubious in order to prima facie disqualify FSFE transactions, it would lead to a slippery slope potentially disqualifying all transactions from NME countries, not just FSFE transactions. This is because the same potential for market-distortive government assistance or influence would be omnipresent in non-FSFE transactions, whether between related or unrelated parties, and would even affect the costs of suppliers in market economies who purchase inputs from NME countries. This would effectively disqualify the use of transaction value, the most common method of customs valuation, whenever participants or inputs from MNE countries are involved.

Similarly, putting aside the practical evidentiary challenges of establishing a negative fact, if a new requirement were to be imposed requiring importers to establish the non-existence of any government subsidies, incentives or control occurring anywhere in the supply chain before availing themselves of FSFE or transaction value, this would potentially render all the other hierarchical valuation methods under the U.S. customs rules unworkable. Simply put, all valuation methods must rely, to some extent, on the NME producer's costs and profits to set the customs value, which in the CIT's view would be inherently dubious.[9] This would become an operational and compliance headache for CBP and importers alike.

While the long-term impact of the *Meyer Corp.* decision is unclear, importers claiming FSFE are well-advised to review and re-validate their programs' compliance. A first step is preparing a "reasonable care" file that includes a diligent analysis of commercial documentation and financial statements to demonstrate compliance. When importing from NME countries, importers may consider obtaining affidavits from their vendors or factories confirming that government subsidies or discounts were not provided. If the foreign suppliers are reluctant to provide the affidavits, the importer may need to further assess the level of risk in continuing to claim the FSFE value for that supply chain flow.

Prior to conducting an ACPP test, the importer should analyze which party is best suited to represent the "firm" overall. Once this determination is made, the rationale should be documented and included in the "reasonable care" file, ensuring there is evidence that the transaction was conducted at arm's length. Importers should also revisit any benchmarking studies in support of the NPPI test, with careful attention paid to ensure that these studies align with CBP requirements (e.g., the same class or kind of goods). In addition, importers should also consider additional comparability screening to mitigate the concerns discussed in the case, including:

— Identifying comparable companies in market economies with similar wages and macro-economic fundamentals as the non-market economy in question

[9] The customs computed value, or "cost plus," method would clearly be affected. Even the deductive value method calculation would be affected since it is based on the importer's resale price to unrelated purchasers minus, *inter alia*, its profit, and the deduction thereof arguably would be tainted by an artificially low or distorted cost of goods sold/purchase price from an NME supplier. Since the fallback method must reasonably be based on a derivative of the other methods, its use would also be impacted.

— Screening companies with sales to the United States that have similar functions, assets, and risk profiles

— Including public or private companies in the study to align with the company under review

Finally, periodic health checks or annual audits of the FSFE program should be conducted to confirm the program's requirements are met. Seemingly minor paperwork adjustments or changes to the terms of the transaction (e.g., Incoterms) can present challenges, however, when addressed proactively, these risks can be mitigated before transactions are disqualified or penalties are incurred. Like any duty savings program, compliance is critical and regular re-validation is the key to spotting both potential opportunities as well as compliance challenges.

Conclusion

The *Meyer Corp.* decision grabbed the attention of trade professionals who use FSFE to reduce overall duty spend out of NME countries, and China in particular. While the CIT's concern with achieving an arm's length price for transactions involving suppliers in NME countries introduced a potentially new hurdle to consider, its practical or legal significance to FSFE is still to be determined. FSFE requirements remain the same for now with respect to both NME countries and free-market countries. However, importers should continue to monitor any further action by CBP in reliance on *Meyer Corp.* and further clarifications from courts, which may provide more instructive guidance about valuing imports from NMEs. Despite these uncertainties, the trade community should use this case as a reminder of the importance of making the proper "reasonable care" inquiries of suppliers, conducting effective arm's length analysis and benchmarking, and verifying and documenting compliance with the FSFE requirements.