

E-ALERT | International Trade & Finance Clean Energy & Climate Industry Group

September 30, 2010

POTENTIAL US-CHINA TRADE DISPUTE OVER CHINA'S CLEAN ENERGY POLICIES

The United Steelworkers union (“USW”) recently filed a Section 301 petition with the Obama Administration requesting an investigation of alleged subsidies and other support provided by China to its domestic “green technology” industries. The Administration now must decide whether or not to initiate an “investigation” of the issues raised in the petition, which would also mean starting the process for bringing a case at the World Trade Organization (“WTO”). The decision could have major ramifications for US and Chinese participants in the renewable energy and cleantech sectors and potentially broader political and economic implications for US-China relations. This e-alert describes the USW petition, the Administration’s pending decision process, and avenues for affected parties to monitor and influence the decision process.

BACKGROUND ON SECTION 301 AND THE USW’S PETITION

The USW’s 5,800-page petition alleges that China engages in various practices that are inconsistent with WTO rules, including:

1. illegal export subsidies and import-substitution subsidies, such as excessive export financing and grants for Chinese producers of wind turbines, solar panels and advanced batteries;
2. laws that discriminate against imports and foreign firms, such as local content requirements for wind and solar plants and exclusion of foreign firms from access to carbon credits arising from Chinese projects;
3. requirements that foreign investors transfer technology to Chinese controlled enterprises in order to receive necessary approvals;
4. restrictions on foreign access to rare earth materials needed for making solar panels, wind turbines, advanced batteries and energy-efficient lighting; and
5. large domestic subsidies to Chinese-controlled green technology industries.

The USW petition is the first Section 301 petition received by the Obama Administration. Section 301 allows any interested party to file a petition with the Office of the United States Trade Representative (“USTR”) requesting that USTR challenge particular foreign trade practices before the WTO. USTR is the Executive Branch agency with primary responsibility for trade negotiations and WTO dispute resolution. USTR has 45 days from the date of filing to decide whether to accept the petition and initiate an “investigation” of the issues raised in the petition. In the case of the USW petition, which was filed on September 9, USTR has until October 24, 2010 to make its decision.

USTR has broad discretion under the statute as to whether or not to initiate an investigation. However, if USTR initiates an investigation, the statute effectively requires that it take certain steps. First, the statute requires that USTR request “consultations” with the Chinese Government either immediately or postpone and make the request within 90 days. Consultations are the first step in

the WTO dispute settlement process. USTR also must publish a summary of the petition in the Federal Register and receive public comments, including through a public hearing if requested by the petitioner or another interested person. If the WTO consultations have not resolved the dispute within 60 days, USTR must request the formation of a dispute resolution panel to hear the case.

FACTORS THAT WILL AFFECT THE ADMINISTRATION'S DECISION

Political factors will be a significant consideration in the Obama Administration's decision. The October 24 deadline is less than two weeks before the November congressional elections and political pressure is already building. On September 28, 181 House members sent the White House a letter supporting the petition and urging the President to take "decisive enforcement action to secure a level playing field for fair competition for green technology manufacturers." The next day the House passed on a bi-partisan vote a China-targeted bill authorizing the government to levy tariffs on imports from countries that subsidize their exports through artificially undervalued currency.

If the administration chooses not to investigate, it will anger organized labor, a key Democratic constituency. Moreover, the solar/wind sector is particularly sensitive because creation of "green jobs" has been a pillar of the Administration's energy/climate agenda. If the promise of new jobs is seen to be receding, this will complicate the energy agenda, especially if unemployment remains near 10 percent.

On the other hand, a decision to investigate risks further complicating US-China economic relations. An investigation would directly challenge China's policies in a sector that China perceives as critical. A WTO case could lead to an international finding that China had violated its legal obligations, which would also be highly sensitive.

The Administration may also be reluctant to initiate an investigation which would encourage the unions (or other interested parties) to file Section 301 petitions alleging unfair practices in other sectors. Historically, past Presidents have been reluctant to initiate Section 301 investigations. For instance, President George W. Bush declined to initiate an investigation against Chinese currency practices.

The Administration may seek creative alternatives to this difficult choice. For instance, the Administration could decide to reject the USW's request at this time but announce that it was starting an internal non-301 review of these issues. Or, the Administration could self-initiate a domestic countervailing duty case against Chinese subsidies. Such a case would have a more limited scope, by focusing more narrowly on the subsidy allegations and by limiting the impact to China's exports to the US market.

THE BUSINESS IMPACT AND POSSIBLE MEANS TO INFLUENCE THE OUTCOME

Businesses in the renewable energy and cleantech sector are in a complex position regarding this potential investigation. On one hand, US and European businesses are increasingly concerned about the competitive disadvantages they believe are caused by direct and indirect government assistance in China. China's indigenous innovation policy, which discriminates against foreign firms in government procurement, was a watershed event in this regard. A WTO case may provide useful leverage for businesses seeking to address these perceived unfair practices.

However, many companies also have significant business interests in China, e.g. through joint ventures, investments and/or licensing arrangements in the solar, wind or advanced battery sectors,

or other business relationships. Companies may be concerned that these interests will be jeopardized if a trade war develops.

Moreover, a WTO case could raise numerous difficulties. First, the panel and appeals process may take years to resolve. Second, because WTO proceedings occur at the government-to-government level, industry does not directly control the strategy or pace of the litigation. Third, the US would expose itself to Chinese counter-claims against US subsidies provided to US green technology producers. Finally, even if the US succeeds in the WTO proceedings, China may delay complying with the WTO's ruling as the US, EU and other WTO members have done in certain circumstances.

Given these challenges, the US and European business community may want to monitor future developments closely and determine whether there are opportunities for initiatives from business coalitions or trade associations to promote a negotiated solution that would achieve a level playing field and clear rules of the game, without a full-scale political battle between the US and China. Opportunities may include:

- Assessing the consistency of Chinese policies with China's WTO commitments;
- Determining the business impact from the Chinese policies at issue, as well as the potential impact from the dispute itself;
- Based on these legal and business assessments, advocating business community views to the Administration and, potentially, to relevant departments of the Chinese government.

One way or another, the Administration's response to the pending Section 301 petition will have implications for the renewable and cleantech sector and any other industry believed to benefit from Chinese subsidies.

Covington has extensive experience in the rapidly transforming renewable energy and cleantech industry and in advising clients on WTO trade matters. Our Clean Energy & Climate industry group and our International Trade practice group have high-level experience with China and the WTO, including serving in senior USTR and Commerce Department positions in direct negotiations with the Chinese government. If you have any questions concerning the material discussed in this client alert, please contact the following members of our practice group:

George Frampton	212.841.1260	gframpton@cov.com
W. Andrew Jack	202.662.5232	ajack@cov.com
William Massey	202.662.5322	wmassey@cov.com
Stuart Eizenstat	202.662.5519	seizenstat@cov.com
John Veroneau	202.662.5034	jveroneau@cov.com
Tim Stratford	86.10.5910.0591	tstratford@cov.com
Peter Lichtenbaum	202.662.5557	plichtenbaum@cov.com

This information is not intended as legal advice. Readers should seek specific legal advice before acting with regard to the subjects mentioned herein.

Covington & Burling LLP, an international law firm, provides corporate, litigation and regulatory expertise to enable clients to achieve their goals. This communication is intended to bring relevant developments to our clients and other interested colleagues. Please send an email to unsubscribe@cov.com if you do not wish to receive future emails or electronic alerts.

© 2010 Covington & Burling LLP, 1201 Pennsylvania Avenue, NW, Washington, DC 20004-2401. All rights reserved.