

United States-Mexico-Canada (USMCA) Free Trade Agreement (NAFTA 2.0) and other Free Trade Agreements

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Overview

- In January 2017, the North American Free Trade Agreement's (NAFTA) three leaders agreed that the time was at hand to “modernize” the (now) 24 year-old pact, launching months of negotiations.
- On September 30, 2018, negotiating teams finally reached agreement on the USMCA. Government leaders in all three countries will now act to debate and approve the negotiated provisions. And this will launch a critical period of rule implementation by all three countries because each country must promulgate Uniform Regulations that will implement the USCMA's various chapters. These regulations must be in place before the USMCA comes into force.
- This is expected to take place throughout 2019 with the USCMA coming into force possibly in early 2020, but entry into force is not guaranteed.
- Like its NAFTA predecessor, the regulations must be implemented consistently by all three countries, hence the term “uniform” regulations. The Uniform Regulations will provide the guidelines for much of the critical fine print relating to qualifying for and claiming USMCA duty-free treatment.
- This period should not be viewed as a “lull.” To the contrary, it represents an important time during which companies can develop their programs and compliance efforts for taking full advantage of the USMCA.
- Virtually every chapter and every aspect of the USMCA uniform regulations will present opportunities for companies to affect the manner in which the Agreement is implemented and the manner in which the company can best utilize the provisions of the Agreement.
- Equally important is the opportunity this period presents to develop a forward looking strategy of international trade competitiveness.

Background on NAFTA

- January 1, 1989 – the Canada – United States Free Trade Agreement (CUSFTA) comes into force, with among other things, tariffs being eliminated in stages over 10 years.
- January 1, 1994 – the North American Free Trade Agreement (NAFTA) comes into force between Canada, the United States, and Mexico. As between Canada and the U.S., the NAFTA supersedes CUSFTA which is suspended while NAFTA remains in force.
- Between 1993 and 2015:
 - Total merchandise trade between Canada and the U.S. more than doubled and between Canada and Mexico increased over 8-fold
 - Canada's goods exports to the U.S. grew at an annualized rate of almost 4.6%
 - Canada added nearly 5.2M new jobs, with unemployment rate dropping from 11.4% to 6.9%
 - US exports to Canada increased by 179%
 - US imports from Canada increased by 165%

Key Provisions of NAFTA

- **Tariff elimination:** Customs duties for goods originating in the NAFTA territory were either eliminated upon entry into force, or progressively phased out over a 5, 10, or 15 year period.
- **Rules of Origin:** The NAFTA introduced detailed rules of origin specifying when goods will qualify as “originating” in the NAFTA territory, entitling them to preferential tariff treatment. The rules stipulate that goods produced in part from non-originating materials must undergo a specified change in tariff classification within the NAFTA territory, or in some cases must contain a specified percentage of North American content.
- **Investment:** The NAFTA grants protection to investors in the form of commitments by member states to the most-favoured-nation and national treatment principles. The NAFTA further provides investors with the ability to challenge allegedly discriminatory measures under an Investor-State Dispute Settlement (ISDS) mechanism.
- **Dispute Settlement:** The NAFTA provides member states with the option to have antidumping and countervailing duty determinations reviewed by independent binational panels as an alternative to judicial review by domestic courts.
- **Other areas of significance:** Government procurement, intellectual property, sanitary and phytosanitary measures, cross-border trade in services, and temporary entry for business persons

US Withdrawal

- NAFTA provides that any country can withdraw “six months after it has provided written notice of withdrawal to the other Parties” – Article 2205
- If withdrawal, NAFTA Implementation Act would remain as US law if or until Congress repealed the statute
- NAFTA would remain in force for remaining two Parties
- Existing NAFTA duty rates would be continued for one year
- Canada and the US have bilateral FTA

Key Provisions of USMCA

- **The following is a summary of a few of the key provisions of the USMCA:**
- **Duties:** As expected, the USMCA provides that, with certain exceptions, originating goods from the three signatory countries shall be duty free, existing customs duties may not be increased and new duties may not be adopted on any originating good. Additionally, the USMCA maintains a series of duty-free entry provisions comparable to some of the US Chapter 98 provisions, including provisions for temporary admission of certain goods, and duty free entry of commercial samples and articles exported for repair.
- **Rules of Origin:** The USMCA maintains the NAFTA criteria for originating goods: (a) wholly obtained or produced; (b) product-specific rules of origin (tariff shift, RVC and/or specific processing requirements); (c) produced exclusively from originating materials; (d) and unassembled parts rule. Additionally, the Chapter on Rules of Origin addresses the following:
 - Retains the NAFTA transaction value and net cost methods for calculating Regional Value Content;
 - Preserves rules relating to intermediate materials, indirect materials, accumulation, and fungible goods;
 - Increases the *de minimis* exception to 10 percent, subject to exceptions for certain products;
 - Sets forth a special rule for sets classified pursuant to GRI 3, a provision allowing for a set that meets certain criteria to be classified in a single tariff number for duty purposes. Under the special origin rule, a set is originating only if each good in the set is originating and both the set and the goods meet the other applicable requirements; except that a set may be originating if the value of all non-originating goods does not exceed seven percent of the value of the set;

Highlights of USMCA

- Essentially NAFTA 2.0
- The pact has been tweaked to include changes for automakers, labor and environmental standards, intellectual property protections, and digital trade provisions.
- Automobiles must have 75 percent of their components manufactured in Mexico, the US, or Canada to qualify for zero tariffs (up from 62.5 percent under NAFTA) to meet country of origin rules.
- 40 to 45 percent of automobile parts have to be made by workers who earn at least \$16 an hour by 2023. Mexico agreed to pass laws giving workers the right to union representation, extending labor protections to migrant workers, and protecting women from discrimination. The countries can also sanction one another for labor violations.
- Terms of copyright extended to 70 years beyond the life of the author (up from 50). Pharmaceutical drug can be protected from generic competition. New provisions to deal with the digital economy, including prohibiting duties on music and e-books, and protections for internet companies so they are not liable for content their users produce.
- US farmers get more access to the Canadian dairy market.

Key Provisions (cont'd)

- Provides that the “Shipped Directly” requirement continues to apply;
- Defines “Non-Qualifying Operations” to include mere dilution, or production or pricing practice, the object of which was to circumvent the rules of origin;
- Increases the Automotive Regional Value Content Rule to require that 75 percent of auto content be made in North America; and
- Imposes a new Labor Value Content Rule, requiring that 40-45 percent of auto content be made by workers earning at least \$16 per hour.
- **Origin Procedures:** Unlike the NAFTA, an importer may make a claim for preferential treatment based on a certification of origin completed by the exporter, producer or importer. The certification need not follow a prescribed format, but the USMCA provides minimum data elements to be included in the certification. Origin certifications may be provided on an invoice or any other document, and may be completed and submitted in an electronic manner with an electronic or digital signature; however, as with NAFTA, the importer must have a valid certification of origin in its possession at the time the preference claim is made.

Key Provisions (cont'd)

- Also similar to the NAFTA, the USMCA retains the exporter and producer recordkeeping obligations for those parties in the transaction who have issued certificates of origin and preserves Customs' ability to conduct verifications of claims for preferential treatment through written requests, verification visits, and any other procedure as may be decided by the parties. Under the USMCA, an importer must also maintain all the records necessary to demonstrate that the good is originating if the claim is based on an importer completed certification.
- **Trade Facilitation:** To facilitate greater cross-border trade, the USMCA provides an increase of *de minimis* shipment value levels in Canada and Mexico. Canada will raise its *de minimis* level for the first time in decades, from C\$20 to C\$40 for taxes and C\$150 for customs duties. Mexico will continue to provide USD \$50 tax free *de minimis* and also provide duty free shipments up to the equivalent level of USD \$117. Shipment values up to these levels would enter with minimal formal entry procedures, making it easier for small and medium-sized businesses to be a part of cross-border trade. Canada will also allow a period of 90 days after entry for the importer to make payment of taxes.

Key Provisions (cont'd)

- **Digital Trade:** The USMCA chapter on Digital Trade provides a foundation for the expansion of trade and investment in the innovative products and services where the United States has a competitive advantage. Among its key provisions is a prohibition on customs duties and other discriminatory measures from being applied to digital products distributed electronically (e-books, videos, music, software, games, etc.).
- Additionally, the USMCA ensures that data can be transferred cross-border, and minimizes limits on where data can be stored and processed, thereby enhancing and protecting the global digital ecosystem. Furthermore, the USMCA aims to facilitate digital transactions by ensuring that suppliers are not restricted in their use of electronic authentication or electronic signatures, and by promoting collaboration on cybersecurity, to keep networks and services secure.
- **Intellectual Property:** The Intellectual Property (IP) chapter provides protection and enforcement of IP rights relating to copyrights, trademarks and patents. Notably, the Agreement includes key enforcement provisions, including *ex officio* authority for law enforcement officials to stop suspected counterfeit or pirated goods at every phase of entering, exiting, and transiting through the territory of any Party.
- With regard to protection of trade secrets, the IP chapter of the USMCA includes various protections against misappropriation of trade secrets, including by state-owned enterprises. Such protections include civil procedures and remedies, criminal procedures and penalties, prohibitions against impeding licensing of trade secrets, judicial procedures to prevent disclosure of trade secrets during the litigation process, and penalties for government officials for the unauthorized disclosure of trade secrets.

Key Provisions (cont'd)

- **Section 232 Auto, Steel & Aluminum Tariffs:** The current tariffs on steel and aluminum have not been removed (though there continues to be talk of negotiations on this thorny issue). Within the new Agreement, a side letter between the US and Canada addresses Section 232 and provides a quantitative exemption for autos and auto parts in the event the US implements Section 232 tariffs on these goods. Additionally, should future 232 Tariffs on other goods be invoked, the side letter provides for a 60 day consultation period for Canada to work with the US to come to an agreement prior to the implementation of any future Section 232 measures.
- **The Sunset Clause:** The USMCA shall terminate 16 years after the date of its entry into force unless the parties wish to renew for another 16 term. However, the USMCA provides that the parties shall conduct a “joint review” of the “operation of the Agreement” every 6 years. As part of this 6-year “joint review,” each Party must confirm, in writing, their desire to extend the Agreement.

Industry Specific Key Provisions

- **Agriculture:** The USMCA represents a significant step forward for the agriculture industry, particularly the dairy sector. All food and agricultural products that have zero tariffs under the NAFTA will remain at zero. Since the original NAFTA did not eliminate all tariffs on agricultural trade between the US and Canada, the USMCA will create new market access opportunities for US exports to Canada of dairy, poultry, and eggs. In exchange, the US will provide new access to Canada for dairy, peanuts, processed peanut products, and a limited amount of sugar and sugar containing products.
- Additionally, the top priority for America's dairy industry in this negotiation has been for Canada to eliminate its program that allows low priced dairy ingredients to undersell United States dairy sales in Canada and in third country markets. As a result of the negotiation, six months after entry into force of the USMCA, Canada will eliminate what is known as its milk classes 6 and 7. By doing so, Canada will ensure that the price for skim milk solids used to produce nonfat dry milk, milk protein concentrates, and infant formula will be set no lower than a level based on the United States price for nonfat dry milk. Canada has also committed to adopt measures designed to limit the impact of any surplus skim milk production on external markets.

Industry Specific Key Provisions (cont'd)

- **Automotive:** While global automakers are worried about the challenges that the USMCA rules will pose, and the impact of these rules when compounded with the potential Section 232 tariffs on automotive goods, the North American automotive industry views the USMCA as vital to the success of the North American auto industry. As noted in the “Rules of Origin” discussion above, the automotive provisions raise the domestic content requirements for passenger vehicles, trucks and parts thereof. The Agreement provides for a staggered increase of the RVC requirement for passenger vehicles and light trucks, starting on January 1, 2020 at 66 percent under the net cost method and increasing by 3 percent per year until it reaches 75 percent in 2023. The Agreement further provides for specific RVC requirements for various auto parts, heavy trucks and parts thereof.
- Additionally, the Agreement imposes a new Labor Value Content Rule, requiring that a certain percentage of auto content be made by workers earning at least \$16 per hour. The percentage starts at 30 percent in 2020, and has a staggered implementation schedule that increases the LVC annually until 2023.

Industry Specific Key Provisions (cont'd)

- **Textile & Apparel:** The new provisions on textiles incentivize greater North American production in textiles and apparel trade, strengthen customs enforcement, and facilitate broader consultation and cooperation among the Parties on issues related to textiles and apparel trade.
- Specifically, the textile and apparel rules promote greater use of Made-in-the-USA fibers, yarns, and fabrics by limiting rules that allow for some use of non-NAFTA inputs and requiring that sewing thread, pocketing fabric, narrow elastic bands, and coated fabric, when incorporated in most apparel and other finished products, be made in the region for those finished products to qualify for trade benefits.
- Adjustments were also made to the Tariff Preference Levels.
- Additionally, the USCMA establishes a Textiles chapter for North American trade, including textile-specific verification and customs cooperation provisions that provide new tools for strengthening customs enforcement and preventing circumvention and fraud.

USMCA Provisions on Energy

- Use of the “Average” Inventory Method was vital in the NAFTA, especially the manner in which the “average” inventory method was implemented. USMCA rules may revise this approach.
- The manner in which fungible goods subject to the average inventory method would then be determined “originating” or “non-originating.” In the NAFTA rules, US and Canada ended up with different allocation methods.
- Possible “guidelines” for use in verifications. For example, in the petroleum industry, NAFTA rules provided that “diluent” used to dilute bitumen will be disregarded as long as it does not exceed 40% in volume of the product. The rules may result in a different approach on this issue.
- A NAFTA rule involving natural gas changed the origin to allow the re-gasification of liquefied natural gas to meet the tariff shift rule. New rules may establish a presumption that, absent information to the contrary, all natural gas imported from Canada should be considered originating (or it may not).

USMCA Provisions on Financial Services

- According to the Office of the United States Trade Representative the United States exported approximately \$115 billion in financial services in 2016, yielding about \$41 billion surplus for trade in financial services. By further leveling the playing field, it is anticipated that the USMCA will grant the three countries wider market access to financial service firms operating in each other's countries.
- The Chapter on Financial Services is in Chapter 17 of the USCMA.
- Under *National treatment* and *Most-favored-nation* treatment principles, financial service firms are ensured to receive equal treatment as local suppliers and firms from any other country, respectively. Market access principles also prohibit host nations from imposing certain quantitative restrictions that would limit the export of financial services to the host country. The USMCA, when it comes into force, will strengthen national treatment protections for the covered financial services industry in all three countries. Enumerated “rules of the road” will ensure transparency and fair treatment.
- A key development in the USMCA is that, unlike the current NAFTA – or any other preceding US trade agreement – there is now a provision prohibiting local data storage requirements, an essential factor impacting the financial services industry. Accordingly, Canada, the US, and Mexico may not impose local data storage requirements on financial service firms as long as the local financial regulator has access to the data for the purpose of carrying out its regulatory, supervisory mandate. This is expected to ease the expense and complication of operating redundant facilities. Access to the host nation financial services sector will also be enhanced through increased regulatory transparency.

USMCA Provisions on Investment

- Chapter 14 (Investment) of the USMCA has significant implications for foreign investments and investment disputes.
- To name a few, Canada is not a party to Annex 14-D (Mexico-United States Investment Disputes) and therefore has not consented to investor-state arbitration under the USMCA.
- Additionally, Chapter 14 limits who can be a claimant, and Annex 14-D limits the bases for investment claims.
- While there are provisions that grandfather pending NAFTA claims and allow for legacy NAFTA claims, investors should evaluate their options and take steps to protect their rights under NAFTA and their investments going forward.

Other Free Trade Agreements

- 2018--US Trade Representative Robert Lighthizer announced the Administration's intent to start talks on new trade pacts with the EU, England, and Japan.

Developing an Action Plan

- Assess your company's exposure and reliance on NAFTA
- Who or what groups in your company determine NAFTA qualification of your product(s)?
- Which specific rules of origin do your company rely on and are they understood and substantiated?
- Do you periodically review this assessment?
- Do you have the necessary resources? Support from company departments? Utilization of NAFTA expertise?
- Does your company's customer rely on your NAFTA certifications?

QUESTIONS?