INTERNATIONAL TRADE

NAFTA TO UNITED STATES-MEXICO TRADE AGREEMENT TO…?
by Daniel D. Ujczo

The United States and Mexico announced on August 27, 2018 a "preliminary United States-Mexico Trade Agreement" (interchangeably referred to in the official US press materials as a "preliminary agreement in principle") that purportedly "modernizes and rebalances" the existing US-Mexico trade relationship. The United States Trade Representative (USTR) Robert Lighthizer intends to issue on Friday, August 31, 2018, the formal notice to Congress as required by the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA-2015) (aka the "handshake") that will start the 90-day consultation period before the US can sign the deal. The anticipated late November 2018 signing date provides Mexico with time to secure passage from its legislature and receive official signature before the December 1, 2018 transition to the new President of Mexico, Andrés Manuel López Obrador (AMLO). The US thereafter will proceed to ratification/implementation by Congress, which will not occur until after the next Congress is seated in 2019.

Surprise!

The most surprising development of the day was Mexico's willingness to proceed with the "handshake" regardless of Canada's involvement in the proceedings. Mexico's current and next Presidents, Enrique Peña Nieto (EPN) and AMLO, each stressed their desire for Canada to be a part of any new agreement. However, the current Secretary of Foreign Affairs, Luis Videgaray Caso, subsequently made several public statements advising that the official notice will issue Friday even should Canada not agree to the terms of the deal. Secretario Videgaray's comments came as quite a surprise (including to those seated on dais with him) as it was anticipated that Mexico would hold out for a trilateral deal throughout the week, as well as attempt to obtain further concessions from the US on the sunset clause. As previously advised in our briefing notes, there are technical challenges (e.g., the bilateral deal envisions 3-way rules of origin on autos and other sectors) and political hurdles (e.g., will Mexico voters believe their country "caved" to President Trump if Canada cannot agree to the same deal) with a bilateral-only deal in Mexico. Nevertheless, all indications are that Mexico is ready to proceed to signature.

Canada Back at the Table

Canada now will participate in the negotiations regarding the agreement, formerly known as the North American Free Trade Agreement (NAFTA), in a challenging environment where the US and Mexico have reached agreement on nearly every clause. The major outstanding Canada-US issues remain supply management (dairy), Chapter 19 dispute resolution, and intellectual property rights (IPR). On a positive note, the official public documents and statements suggest a possible lane for resolution to the dairy issue. Specifically, the USTR fact sheets indicate that the parties agreed "[i]f supporting producers, to consider using domestic support measures that have minimal or no trade distorting or production effects, and ensure transparency of domestic support and supply management programs." The permissive language may afford opportunities to narrowly target the negotiations on the negative impact of Canada's alleged slippage of excess/waste dairy product into the global market, as opposed to the broader and politically untenable elimination of supply management as well as the equally unreachable dismantling of Class 7 (diafiltered/ultrafiltered milk). In the event the dairy issue is narrowly tailored, there are potential solutions for reaching a win-win solution.

On the negative side, Chapter 19 received no attention in the bilateral negotiations and USTR Lighthizer's comments appeared to suggest that he has a clear path to seek its elimination, which is notably a "red-line" for Canada. Regarding IPR, the official materials indicated that the US-MEX agreement in principle establishes biologics (10 year patent protections), copyrights (moving from 50 years to 75 years), safe harbor/take-down rules for internet service providers (ISP), and requiring border agents to stop counterfeit/pirated goods, that extend beyond where Canada previously has been willing to go in trade or bilateral negotiations.

The list of potential challenges to a trilateral deal also expanded in the US-MEX agreement in principle. The financial services provisions included the broadly worded language found in USTR's July 2017 Statement of Objectives which may be problematic to Canada; particularly, as there has not been much discussion to date on these matters. Several other areas in the US-MEX agreement in principle such as de minimis shipments and grain/wheat grading standards touch on existing Canada-US disputes, further adding to the wide ground to cover in less than a week.

Friday's Notice

Against this backdrop, the most likely scenario is that the US and Mexico will issue the formal notice on Friday to "start the clock" on the 90-day consultation period. In the unlikely event that the "Canada issues" are resolved, the parties will proceed to consultation and signature. However, as previously advised in our briefing notes, it is likely that the parties will use the 30 day interim between the issuance of the notice and the date upon which the text of the agreement must be published on USTR's website to resolve any remaining issues with Canada. This scenario was not envisioned by TPA-2015 but it is unlikely that Congress will disrupt the negotiations unless it becomes clear that no deal with Canada is possible. Consequently, the negotiations with Canada likely will continue throughout September.

Section 232 Steel and Aluminum Tariffs

It is highly unlikely that there will be an announcement regarding the Section 232 steel and aluminum tariffs and Mexico's retaliation this week. The US and Mexico are discussing a quota-based structure for the steel and aluminum imports into the US and more time is needed. Secretario Videgaray's announcement that Mexico would agree to the Friday notice eliminated any leverage Mexico had to speed up

that process. Canada may be able to raise the issue in its discussions; however, progress will be unlikely given the long list of issues. The lifting of the tariffs on Mexico, and potentially Canada, likely will be announced during the 90-day consultation period between the "handshake" and signature.

Congress as the "Wildcard"

While we try to remain optimistic, it is unlikely that the discussions between the US and Canada over the coming days will have a positive tenor and tone. The comprehensive and fait accompli nature of the US-MEX bilateral deal, the "ticking clock", and the existing (steel and aluminum) and threatened (autos) Section 232 tariffs, do not foster a favorable negotiating environment. The three parties possess the most highly skilled negotiators on the globe; however, the time needed to get up to speed on the new deal and stake out positions is limited. A good outcome for the week is to make any progress that propels the parties to reach a deal during the ensuing 30 days.

Prior planning prevents pitifully poor performance and one should be prepared for a potential collapse of negotiations between Canada and the US. At present, there is a strong consensus in the US Congress—including leadership in the key trade committees—as well as the business communities for a trilateral deal. Congress can use its consultative role in TPA-2015, including measures such as disapproval resolutions, to compel a trilateral deal. As repeatedly advised in our prior briefing notes, however, TPA-2015 does not prevent a bilateral deal as a matter of procedure. Rather, it is the political determination of Congress, driven by the practical considerations of North America's inextricably intertwined supply chains, which foster a trilateral agreement. It must be emphasized that this Congressional support is not unlimited in duration. The US-MEX agreement in principle contains many key "wins" for Congress on autos, labor, IPR, agricultural interests and "pet projects" for certain members. Should this drag on, members of Congress will begin to balance those interests against what will be cast as Canada trying to protect dairy and lumber (via Chapter 19), and cheating US intellectual property holders. Attempting to "wait this out" is not an option.

Withdrawal

President Trump mentioned in his comments that he intends to withdraw from the existing NAFTA at the time he presents the new deal to Congress. Dickinson Wright has been predicting this scenario since our late-2017 briefing notes as a political strategy to eliminate a safe "status quo" vote for Congress. Specifically, Congress will have the option of voting for the President's NAFTA or run the risk of no NAFTA at all. There are several procedural challenges to this approach, including the 6 month notice required to withdraw from the NAFTA and the legal grey area as to whether the President can withdraw without the consent of Congress. USTR attempted to brush off these concerns today and suggested that some type of solution will be reached. Dickinson Wright will continue to monitor.

Automotive Rules of Origin

Further to prior briefing notes, the following are the key elements of US-MEX auto rules of origin:

- A top-line regional value content of 75% (up from 62.5% in the current NAFTA);
- 70% of all steel, aluminum, and glass used in the production of the automobile must originate in North America;
- Up to seven components, including most of the powertrain assembly, must originate in North America;
- If a plant is used in the production of the automobile that provides less than the North American wage (approximately USD16.00), 40% (passenger vehicles) and 45% (light duty trucks) of that final vehicle's assembly must be made with at least the North American Average Wage;
    - In calculating the final vehicle produced at the North American Average wage, up to 15% (20% for light duty trucks) of that requirement may include R&D, marketing, sales, etc. salaries. Otherwise stated, companies may not work-around the wage requirement by simply bolstering professional salaries as workers "on the line" must be part of the calculation; and
- The imposition of a 4 year phase-in period.

The US-MEX Agreement in principle also agrees that non-conforming passenger vehicles within the existing footprint, as defined by the passenger vehicle capacity per plant, will be subject to no higher than the most favored nation (MFN) rate of 2.5%. Non-conforming light duty trucks in the existing footprint will be subject to the current 25% tariffs.

Non-conforming autos and trucks produced at new investment locations will not be guaranteed the 2.5% MFN rate. As a result, in the event the US imposes Section 232 auto tariffs, new investment in Mexico will have exposure to such tariffs. Contrary to other reports, Mexico and the US did not agree to a fixed tariff rate higher than 2.5% for new investment.

Labor

The labor provisions of the US-MEX agreement in principle require review by all parties operating or utilizing production in Mexico. The new terms will direct Mexico's ongoing domestic labor reforms, define a "persistent pattern of non-enforcement of law", require adherence to the International Labor Organization (ILO agreement), among other provisions that go well beyond Mexico's existing commitments. Management-labor relations policies in Mexico will require revision for most companies.

Chapter 20

Mexico and the US agreed to maintain the current state-state dispute resolution mechanism.

Chapter 11

Mexico and the US agreed to a modified investment state dispute settlement regime (ISDS) that provides protections for the oil, gas, infrastructure, and telecommunications sector (those sectors that routinely deal with government procurement) and more limited protections for all other sectors.

Seasonality

The US withdrew its seasonal produce proposal.

Sunset

The US and Mexico agreed to a 16 year sunset clause that requires the parties to review the agreement every six years and, if approved, renew the agreement for 10 years. If the parties are unable to agree to renew the agreement, they will attempt to work out all differences during the remainder of the term.

Dickinson Wright will continue to monitor all developments and provide analysis. Companies meanwhile must prepare for the various contingencies as well as make ready for a quick review of the text of the agreement that will likely be released at the last minute in September. Time is short to develop analysis and, if necessary, prepare congressional outreach strategies.

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