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NAFTA Reintroduced as USMCA: What You Need to Know

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Introduction

After lengthy and intense negotiation, the North American Free Trade Agreement (NAFTA) has been reintroduced as the United States-Mexico-Canada Agreement (USMCA), the new tri-party trade deal to establish various tariffs, measures, and protections between the party nations. The earliest the agreement can be signed by the parties is November 29, 2018. However, each country must also go through its own ratification and implementation process and there may be changes to the deal as a result. While the deal will likely not come into effect until mid 2019 at the earliest, here are some high-level implications that will affect various sectors in the market.

We will be following the status of the USMCA and post more detailed information on various sectors as more information becomes available.

Trade Remedies and Other Dispute Resolution

Prime Minister Trudeau identified the protection of dispute resolution mechanisms as a key objective for Canada, particularly regarding trade remedies. Chapter 19 of NAFTA contained a review mechanism of antidumping and countervailing duties, which allowed a country to block imports if it believed that the exporting country was acting unfairly. Canada has successfully relied on Chapter 19 in previous disputes, particularly regarding softwood lumber. This mechanism has been maintained in what is now Chapter 10 of the USMCA, though it will only apply to Canada and the US.

The USMCA also reaffirms the safeguard rights from the World Trade Organization (WTO) Agreement on Safeguards granted to each of the nations, while still exempting party members from global safeguards as previously found in Chapter 8 of NAFTA. This is of note as the tentative bilateral agreement entered into between the US and Mexico had potentially granted immunity to Mexico from safeguard action, something that had caused concerns amongst US industrial producers and their ability to be protected from surging imports.

However, the private investor-state dispute settlement (ISDS) provisions of NAFTA Chapter 11 have been removed from the USMCA. Under NAFTA, a private investor or company could bring a grievance against a government and have that complaint heard by a NAFTA tribunal, as opposed to the states own court system. Chapter 14 of the USMCA contains transition provisions related to phasing out ISDSs, and introduces numerous limitations on those seeking to make claims. Parties' consent to legacy investments

(those investments established during the lifetime of NAFTA) will expire three years after NAFTA is terminated. The loss of these ISDS protections leaves individual investors with limited enforcement mechanisms against the member governments. Once the transition period has lapsed, breaches of investment protections will only be able to be addressed through the state-to-state dispute settlement mechanisms of Chapter 31 of the USMCA. ISDS protections will likely remain as between Canada and Mexico since both are party to the Comprehensive and Progressive Agreement for Trans Pacific Partnership, which contains similar provisions.

Agriculture, Dairy and Supply Managed Markets

Canada's agricultural industry is largely controlled by a supply management system that coordinates the supply and demand of goods such as dairy. While the system is largely maintained, Canada made numerous concessions in the USMCA, particularly in the dairy industry. Under a supply management system there is a production quota to control how much a supplier produces of a certain product, and tariff-rate quotas (TRQs) which restrict how much product can enter the country under low or no tariffs; once the TRQ is exceeded extremely high tariffs are imposed.

Under the USMCA, Canada has agreed to increase the TRQs for dairy imports in a number of product categories. This will lead to increased access by US dairy farmers to the Canadian market – it is estimated that the US will be able to export the equivalent of 3.6% of Canada's market. The following examples of TRQs show the range for quotas over the first six years of the agreement. Starting in the seventh year the quantity will increase 1% a year for the subsequent 13 years.

- Milk: 8,333 metric tonnes in year one and 50,000 metric tonnes in year six (85% of the TRQ must be of milk in bulk for further processing into dairy products)
- Cream: 1,750 metric tonnes in year one and 10,500 metric tonnes in year six (85% of the TRQ must be for further processing)
- Cheese for industrial use: 1,042 metric tonnes in year one and 6,250 metric tonnes in year six
- Cheese of all types: 1,042 metric tonnes in year one and 6,250 metric tonnes in year six

There will also be increased TRQs for a variety of other products such as eggs, egg products, and poultry.

The agricultural chapter contains several annexes, some to note are:

- Canada US Bilateral Annex
- Alcohol Annex
- Proprietary Food Annex

Rules of Origin – The Automotive Sector

Chapter 4 of the USMCA lays out criteria for determining if a product has enough North American content to be eligible for preferential tariffs under the agreement. In the automotive industry, the regional value content will increase gradually over time up to 75% (up from 62.5% under NAFTA). Further, at least 70% of steel for vehicles and heavy trucks must be sourced from North America.

There are also minimum wage requirements for the auto industry in place. To be considered originating and able to benefit from the USMCA, at least 30% of cars (increasing to 40% by 2023) must be manufactured by workers earning a minimum of US$16 per hour. Though this will likely benefit businesses in the automotive sector it will likely increase costs to consumers.

In the United States-Canada 232 Process Side Letter (the 232 Side Letter), Canada secured additional protections for the automotive industry. The US committed to provide at least a 60-day exemption for any future use of the Section 232 measures from the US Trade Expansion Act of 1962. In the event that Section 232 measures are subsequently implemented, there are exemptions guaranteeing duty-free access to the US market for 2.6 million Canadian automobiles, provided they qualify as originating. Similarly, duty-free access to the US market for US$32.4 billion worth of Canadian auto parts has been persevered.

Government Procurement

The current text suggests that the government procurement provisions of the USMCA only pertain to the US and Mexico. If this remains the case, Canadian suppliers will need to rely on procurement provisions of other trade agreements, namely the WTO Agreement on Government Procurement for the US and the impending Comprehensive and Progressive Agreement for Trans-Pacific Partnership for Mexico.

Anticorruption

One notable addition to USMCA is the new anticorruption chapter that lays out a common framework and commitment by the three countries to address corruption in international trade and investment. The parties acknowledge the importance of compliance programs and international cooperation.

Security Measures

Chapter 32 of the USMCA contains a security clause that allows a party to apply measures “it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.” This exemption goes further than the one in NAFTA the WTO exemption as it places less restrictions on use, such as the requirement that the clause only be applied in times of war.

Though the USMCA does not directly deal with the tariffs on steel and aluminum products imposed under Section 232, this provision could likely be relied on to protect those tariffs. However, the 232 Side Letter will

at least give Canada a 60-day exemption from any future tariffs moving forward.

IP and Copyright

Chapter 20 addresses the standards the parties will set for intellectual property protection. Of note, provisions provide for updates to the patent laws that would allow for patent term extensions to compensate for unreasonable delays attributable to the patent office (more than 5 years after filing or 3 years after a request for examination). The chapter also includes data protection provisions to account for regulated products such as agricultural chemical products and biologics, adding 10 years of protection from the date of marketing approval. For copyright, the chapter mandates the term for copyright protection be the life of the author plus 70 years (an increase from life plus 50 years currently in Canada). The chapter further calls for improved protection of trade secrets more in line with the more developed system in the United States. Overall the USMCA mandates fulsome protection of intellectual property rights, with strong procedures in place for enforcement of those rights including improved border enforcement.

Side Letters

There are twelve side letters appended to the main agreement, which can be binding or non-binding, but can have significant implications (for example, the 232 Side Letter). Another of interest is the United States-Canada Side Letter on Wine, which recognizes the complaints the US has lodged with the WTO over polices which permitted only the sale of B.C. wine in their local grocery store shelves, while imported wines were left to be sold only though a “store within a store” concept. The letter calls for Canada to modify these policies to settle their dispute at the WTO. There are additional side letters between the parties on a variety of topics, ranging from water to auto safety standards.

Other Provisions to Note

Unlike NAFTA, the USMCA contains a “sunset clause.” USMCA will expire after 16 years unless renewed. In addition, after 6 years the countries will review the agreement and determine if that term should be extended.

One potential way the USMCA could end before the 16-year term is if any party enters into a free trade agreement with a “non-market country.” The USMCA require that a party give 90-days’ notice before commencing such negotiations. The other parties will then have the right to review the full text of the proposed free trade agreement and to withdraw from the USMCA with six-months notice so as to replace USMCA with a bilateral agreement. This provision is widely being seen as to limit Canada’s ability to negotiate trade deals with China.

It is also worth noting that under Article 34.4, amendments to provisions from the WTO Agreement that are referenced in the agreement will not automatically amend the USMCA, but rather bring the countries

together to consult on whether the USMCA should be amended as well.

Canadian consumers, particularly those with an affinity for on-line shopping, will benefit from an increased de minimum exception for duty-free shopping. Canadians can now order up to C$40 from US retailers without paying taxes and up to $150 without paying any duties.

Conclusion

Although the release of the agreement's full-text is momentous, the agreement still must be signed, ratified, and implemented by each country. As per Article 34.5, the USMCA will come into force on the first day of the third month following the final party completing its implementation procedures.

While we do not anticipate this occurring until sometime mid-2019, we intend to continue diving into the agreement to learn more about how our clients can best prepare for the entry of the new trade deal.

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This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.