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Trump Administration Reaches Preliminary NAFTA Agreement with Mexico; Seeking Canada's Buy-In by Friday, Trump Re-Introduces Threat of 232 Auto Tariffs Opposed by U.S. Auto Industry

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BREAKDOWN OF THE NAFTA PRELIMINARY AGREEMENT

On August 27, 2018, President Trump's and Mexico's Enrique Peña Nieto congratulated each other in a conference call for reaching "preliminary agreement in principle" in regards to the North American Free Trade Agreement (NAFTA).

This new agreement is intended to replace the 24-year-old NAFTA agreement with modern provisions addressing the new technological realities of doing business. It also intends to give a solution to the Administration's priority to re-shore manufacturing to the United States.

The announcement was welcomed by some U.S stakeholders. The Mexican peso rallied and S&P 500 and the NASDAQ reached record-high closes. However, the deal is preliminary thus far from concrete. Substantial hurdles remain; including Canada's consent and ratification by all countries. However, there were concerns expressed among many segments of the US business community, such as the National Association of Manufacturers (NAM).

At the conclusion of the conference call, President Trump mentioned —off the cuff— he intended to terminate NAFTA and substitute it with the United States - Mexico Free Trade Agreement. His comments would suggest that he is seeking a bilateral agreement with Mexico first, leaving Canada on the sidelines. However, the President's comments were mostly ignored by financial markets and were widely considered to be a negotiation strategy to pressure Canada to accept the new agreement by the end of the week. This is a way for President Trump to convey to his supporters that he kept his campaign promises of withdrawing from NAFTA since the new agreement would not be called NAFTA.

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The reasoning is that the President's authority to enter into free trade agreements stemming from Trade Promotion Authority (TPA) granted by Congress is limited. TPA lays out specific timelines and reports that need to be submitted to Congress. Following the TPA statute, the USTR on May 18, 2017, notified it intended to start negotiations with Canada and Mexico regarding the modernization of NAFTA. Since USTR's notification to Congress included both, Mexico and Canada, it is considered by some that the President does not have the authority to enter into a separate bilateral deal with Mexico.

Several Congress Members have already warned the President that if he intends to negotiate and enter into bilateral deal with Mexico (without Canada), he would be required to submit a new and different notification to Congress in accordance with section 105(a)(1)(A) of the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA or Fast Track). Originally this position was promoted by four Democratic members of the House Ways and Means committee including Michigan's Sandy Levin. However, more recently some prominent Republicans have joined in, most notably Senator Toomey from Pennsylvania who published an Op-Ed in the *Wall Street Journal* indicating he would vote to deny Fast Track unless the President presents a trilateral deal. There has even been discussion of a so-called "nuclear option" under section 106(b)(1) that allows either house of Congress to adopt a procedural disapproval resolution if the President is not in compliance with the TPA. If this position prevails new consultations, hearings, reports, and summary of negotiation objectives would need to be submitted again specific bilateral Mexico agreement. This would significantly delay the signing of the new agreement. Notwithstanding, the USTR mentioned on Monday that they will notify Congress on Friday (8/31) of their intention to sign a bilateral trade agreement with Mexico —or inform lawmakers of a trilateral pact that includes Canada— if Canada reaches a deal in time. There are those who believe that the original notification to Congress that mentioned negotiating with both Mexico and Canada could be interpreted to cover an agreement with either rather than both. After the letter is sent to Congress, an agreement could be signed potentially by November 29 but only if the text is released by September 30. It is not yet clear if the language of the texts is already agreed upon or close.

Time is of the essence for Mexico and the United States, in terms of political consequences. The new Mexican President takes oath on December 1 and does not want to have to sign the new NAFTA. The US also has mid-term elections coming up in November.

The new agreement texts remain classified; thus, exact language remains unknown. However, we will generally recount what has been reported according to a fact sheet published by the United States Trade Representative and other sources. **This information is subject to change.**

Rules of Origin (Auto): Autos produced in Mexico will have tariff-free access to the US market as long as 75 percent of their components were made in North America — compared to 62.5 percent now. Autos that do not meet the modernized NAFTA rules of origin will pay a 2.5 percent tariff if they are made at an existing manufacturing facility. Autos non-conforming to new rules of origin rules made at new plants could be hit by Section 232 tariffs on auto imports if so imposed. New trade rules of origin to drive higher wages by requiring that 40 - 45 percent of auto

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content be made by workers earning at least \$16 USD per hour. This requirement will favor the US and Canada where wages are much higher than in Mexico. Furthermore, the parties agreed to a potential cap of Mexican motor vehicle parts exports into the U.S. with a dollar value cap on autos and trucks and a numerical value on parts. This is essentially a quota, similar to what was required in the 232 steel and aluminum case for countries to be excluded and which were agreed to by Korea, Brazil, and other countries.

Section 232 Tariffs on Autos: The proposed U.S.-Mexico trade deal indicates that the Trump administration used the threatened 232 auto tariffs as part of its negotiation strategy. The proposed bilateral deal would allow the President to impose “national security” tariffs of up to 25 percent on imports of Mexican-made cars, sport utility vehicles and auto parts above certain volumes. A side agreement between the two countries would allow the United States to pursue national security tariffs on annual Mexican car and SUV imports of over 2.4 million vehicles, a number that significantly exceeds last year’s total imports. The side deal would allow any future national security levies on auto parts imports above a value of \$90 billion per year on the same grounds. Mexico would reserve the right to challenge the U.S. use of “national security” tariffs at the World Trade Organization

Sunset: Under the U.S.-Mexico deal, the official said, the trade agreement would run for a term of 16 years; every six years, the three countries would have the opportunity to renew it for another 16 years.

Dispute Resolution: New agreement softens, but does not eliminate investor-state dispute (ISD). Originally the US wanted to make the ISD chapter voluntary so countries could opt-out but this was withdrawn. The agreement would keep such protections for industries like energy, telecom, and infrastructure. Other industries will have limits imposed on Investor-State disputes. Mexico and the US also agreed to remove extra protections to contest anti-dumping tariffs in front of trilateral dispute panels rather than in the courts (existing Chapter 19). Also, a limited dispute resolution provision is reported to be applicable to financial services companies. It is reported that before a party can resort to bringing an ISD dispute to an arbitration panel that it must make efforts to exhaust its remedies at least partially in the local courts and wait a 30 month period for bringing the claim. Oil, Gas, and Infrastructure companies are covered by ISD if they have a contract with the Mexican government.

Labor: The Labor chapter includes an Annex on Worker Representation in Collective Bargaining in Mexico, under which Mexico commits to specific legislative actions to provide for the effective recognition of the right to collective bargaining. The Labor chapter requires the Parties to adopt and maintain in law and practice labor rights as recognized by the International Labor Organization, to effectively enforce their labor laws, and not to waive or derogate from their labor laws. Additionally, the chapter includes new provisions to take measures to prohibit the importation of goods produced by forced labor, to address violence against workers exercising their labor rights, and to ensure that migrant workers are protected under labor laws.

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Agriculture: most zero duties will continue but Mexico still has 20% tariff on US pork. Phytosanitary and biotech chapters are included genetic engineered products. Some Geographic indications of origin were approved for example for certain cheeses. Recognition was given for Mexico's exclusive right to use the terms Tequila and Mescal and the U.S. to use Bourbon and Tennessee Whisky.

Customs Formalities: The U.S. has an \$800 "*de minimis*" rule to allow small shipments (usually FedEx and UPS) to avoid payment of duties and customs formalities. Mexico had only a \$50 level. Mexico agreed to increase this to \$100 but many U.S. companies are not satisfied with this.

The full USTR announcement can be found [here](#). It appears to be written more as a marketing document praising the U.S. accomplishments rather than providing a great deal of useful hard information.

President's steel and aluminum tariffs (and retaliatory tariffs on the U.S.) will remain in place until the countries are closer to "certainty of signing an agreement before" Nov. 30.

Since the start of NAFTA renegotiations and tariff implementations (Section 232 and 301), we have been helping clients navigate the implications of new trade regulations in their business. We can assist you in developing strategies to assess and mitigate risk arising from regulation changes. See law alerts on these topics on the following links. (August 9, August 2, July 11, July 9, June 15, and April 4.)

We will update this alert as further information becomes publicly known.

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