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Trade Rules You Must Know In the Automotive Industry In 2021: USMCA

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When Stellantis became the 4th largest automaker in the world after the PSA-FCA merger, it reinforced the global nature of the automotive industry and the interest global companies (e.g. former PSA) have in doing business in the United States. The implementation of Section 232 and 301 tariffs (discussed in our client alert of January 21, 2021), as well as the passing of the United States Mexico Canada Agreement (USMCA) on trade, are evidence that the United States government has been reacting to these forces. Notably, while the Trump Administration initiated Section 232 and 301 tariffs, the Biden Administration appears unlikely to get rid of them any time soon. Similarly, while President Trump initiated the replacement of NAFTA with what is now the USMCA, both the House in 2019 and the Senate in 2020 passed it with bipartisan support. This Alert focuses on the issues we expect the USMCA will present for the automotive industry in 2021.

The US, Mexico, and Canada reached an agreement in 2018, after more than a year of negotiations, to replace the North American Free Trade Agreement ("NAFTA"), and was signed into law by President Trump in January 2020. Since then, Butzel attorneys have been busy counseling clients on not only themselves to complying with the USMCA requirements, but also on ways for companies to market their compliance as a competitive advantage to their customers. The effective date of the Agreement was July 1, 2020; unfortunately, the USTR, Customs, and the Department of Labor did not issue important implementation and guidance documents until days before (or in some cases even after) the effective date, causing uncertainty among importers and exporters in the North American region. In our view, these are the most significant features of the Act for automakers and auto-part suppliers:

1. **"Deemed Originating" is no more.** The highest value of vehicle content is in electronics and technology parts. The

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USMCA effectively eliminates the “deemed originating” loophole for compliance that allowed much of modern vehicle content (e.g. sensors, Lidar) to skirt the regional value requirements under NAFTA. Consequently, tracing lists are no longer required. All content must now comply with the product-specific rules of origin to qualify for preferential duty treatment.

2. Tariff Shift Requirements and Increased Regional Value Content Requirements. The USMCA classifies vehicle parts into three main categories; core (super-core) (e.g. engines and transmissions), principal (e.g., glass and tires), and complementary, (e.g. valves and batteries). On average, Regional Value Content “RVC” increased for passenger vehicles and parts thereof from 62.5% to 75%. However, part-specific regional value requirements and tariff shift requirements depend on the classification of each vehicle part as provided by Annex 4-B and its Appendix based on the Harmonized Tariff Schedule. The USMCA retains NAFTA’s ways of calculating RVC, using the transaction value method or the net cost method. Both methods provide for the subtraction of non-originating materials for calculation purposes.

Also, the USMCA retains the rule to designate self-produced materials as intermediate materials. The intermediate material designation helps treat vertically integrated manufacturers in nearly the same manner as manufacturers who purchase materials from independent suppliers. Simply said, if you add too much foreign or non-originating material (material that is not from the US, Mexico, or Canada) it may disqualify your product from receiving preferential duty treatment. This effect cascades down to inputs provided by your suppliers. However, a sliver of good news is that the de minimis threshold of non-originating materials was increased in USMCA to 10% from its previous NAFTA level of 7%.

3. The USMCA provides for new Labor Value Content (“LVC”) requirements not previously required by NAFTA or any other free trade agreement. The new requirement is meant to discourage the outsourcing of manufacturing jobs to low-wage plants in Mexico. Under the USMCA, vehicle manufacturers will need to self-certify that their production meets LVC requirements. These requirements state that the following percentages of a vehicle must be made in facilities with a production wage rate of at least \$16 per hour: (1) for passenger vehicles, up to forty percent (40%) of the product’s value; and (2) for trucks, up to forty-five percent (45%). The LVC formula is the sum of high-wage materials and manufacturing, technology, and assembly expenditures. Also, the formula may be calculated on the basis of category (model line, class of motor vehicle) and time (previous calendar year, fiscal year, quarter or month to date, etc.). Each one of these components merits its own analysis in a separate client alert, suffice to say that the calculation method of the LVC is highly complex.

These requirements apply only to the original equipment manufacturer (OEM), but the concern for suppliers is that the OEMs will try to pass them on. At the very least, OEMs are likely to use LVC to demand additional access to product’s costs from their suppliers in order to make their own determinations as to whether a vehicle complies with the LVC requirement. Please note that LVC Requirements (Chapter 4) are distinct from USMCA labor rights requirements (Chapter 23-A).

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4. In addition to the product-specific rules of origin and Labor Value Content, a passenger vehicle, light truck, or heavy truck will be originating only if, during the prior year, at least 70 percent of the vehicle producer's purchases of steel and aluminum are considered originating as well. The countries further tightened this rule by adding a requirement that, beginning seven years after the entry into force of the USMCA, steel may only qualify as originating for purposes of Article 6 if "all steel manufacturing processes...occur in one or more of the USMCA countries, except for metallurgical processes involving the refinement of steel additives.

5. The USMCA allow producers (or exporters) of goods to choose to include as part of the goods' RVC any regional value added by suppliers of non-originating materials used to produce the final goods. When two or more locations in North America are involved in the production of the good, the certifier may include costs incurred in both locations in its net cost RVC calculation. USMCA allows the production undertaken on a non-originating material in the territory of one of the parties to contribute toward the originating status of a good regardless of whether that production was sufficient to confer originating status to the material itself. As a result, accumulation allows the producer to reduce the value of the non-originating materials used in the production of the good by considering the USMCA inputs incorporated into those non-originating materials.

6. A good shall not be considered to be an originating good if a pricing practice was adopted merely to circumvent RVC. This will be shown by a preponderance of the evidence that the object will circumvent Chapter 4 requirements.

Automakers and auto-parts suppliers will have to consider each of these issues in 2021 not only with respect to USMCA enforcement, but also with regard to the impact on their existing and prospective contractual responsibilities, especially those involving compliance with new origination requirements. Some contracts may only require suppliers to provide information necessary to ascertain origination criteria under the USMCA, while others may require specific compliance with rules of origin. OEMs have great flexibility to amend their terms and conditions unilaterally, and we have already seen attempts to pass down requirements to their supply base.

Regarding enforcement, the Implementing Instructions under the Act allow for a measure of discretion in the enforcement of the new rules of origin. During the first six months of the Agreement, Customs and Border Protection has taken into account the difficulties importers may face in complying with the new rules, as long as importers are making satisfactory progress toward compliance and are making a good-faith effort to comply with the rules. While we have not seen significant enforcement action during this time period, note that discretionary enforcement does not mean suppliers are not required to meet origination requirements. Customs announced that full enforcement has begun on January 1, 2021.

The Biden administration has announced that its focus, for now, will be on COVID-19, economic stimulus rather than trade-related issues, which suggests there will be no immediate changes to the trade policies implemented by the previous administration. The issues facing companies in light of USMCA are here to stay for now. How companies approach their USMCA obligations will require

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diligence and a holistic approach. Your Butzel team is here to assist, and to counsel that your company has the opportunity to use these new rules to their advantage.

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