Hogan Lovells

USMCA's 1 July entry into force: Key implementation and compliance issues

21 May 2020

On 24 April 2020 United States Trade Representative (USTR) Robert Lighthizer notified Congress that the United States-Mexico-Canada Agreement (USMCA) will enter into force 1 July 2020. As a result, the North American Free Trade Agreement (NAFTA) will no longer be in effect as of this date. U.S., Canadian, and Mexican importers and exporters should thus be aware of: (1) key implementation and compliance issues; (2) new U.S. regulatory guidance; and (3) other important changes impacting labor investigations, intellectual property protection, dispute settlement, digital trade, and USMCA's termination.

Key implementation and compliance issues

USMCA's entry into force will bring several changes to how goods are currently imported under NAFTA, including:

- ***Rules of origin for duty preference***

  USMCA has made significant adjustments to NAFTA's rules of origin (ROOs), particularly for certain textiles and apparel, chemicals, pharmaceuticals, electronic products, energy products, and automotive products. Consequently, products that previously qualified for duty preferences may no longer qualify and products that previously did not qualify may now qualify. For example, USMCA will require that certain elastic fabric, sewing thread, pocketing fabric, and coated fabric in apparel be sourced from a USMCA Party in order for the product to receive preferential treatment. Conversely, USMCA will increase the *de minimis* thresholds for non-originating goods from 7 percent to 10 percent, meaning more goods may qualify for preferential treatment under this exception than NAFTA.

  The most noteworthy changes have been to the automotive ROOs, which are more stringent and complex under USMCA. Specifically, USMCA includes three automotive ROOs, which must be met to receive preferential treatment. The first is an increase in the overall vehicle regional value content (RVC). The second is a part-specific RVC rule. The third is a newly created labor value content (LVC) rule, under which a certain percentage of vehicle content must be made by workers earning at least US$16 per hour. USMCA provides for a phase-in period for these changes. In addition, automakers must annually certify that 70 percent of the steel and aluminum used in their vehicles must originate in Canada, Mexico, or the United States. There is no phase-in period for this 70 percent requirement. However, by year seven, the steel must be melted and poured, not just finished, in North America to be considered an originating good. In year 10, the Parties must consider origination standards for aluminum. These ROOs changes will not only impact finished vehicles, but the entire automotive supply chain.

- ***Merchandise Processing Fees***

  Like NAFTA, importers will still be able to make a post-importation claim for preferential tariff treatment within a year of the good being imported. However, the merchandise processing fees (MPF), which can add up, will no longer be refunded.

- ***Certificates of origin***

  Under NAFTA and USMCA, importers claiming preferential tariff treatment for products from Canada and Mexico must possess of a valid certificate of origin. USMCA's process of obtaining a certificate, however, will be administratively less burdensome. For example, currently only exporters or producers can complete the certificates of origin. Moreover, the only acceptable format is a U.S. Customs Form 434.

  Under USMCA, however, an importer will also be able to complete a certificate of origin. And there is no prescribed format for the certificates of origin. Instead there is specific information that must be included in the certification of USMCA origin. Importers, however, may have a difficult time collecting the necessary information, particularly if they are unaffiliated with the exporter. But, so long as the NAFTA and USMCA rules of origin are the same for the materials and for the finished good, the importer should be able to rely on existing NAFTA certifications in preparing its new USMCA certifications, which must be in the importer's possession at the time of importation if making a USMCA preference claim on or after 1 July 2020.

- ***Country of origin marking rules***

  Under U.S. Customs law (Section 304 of the Tariff Act of 1930), companies importing into the United States from all countries must label non-U.S. origin goods with their country of origin. Currently, the rules for determining origin for the marking/labeling of goods imported from Canada and Mexico are codified in Part 102 of the Customs Regulations (NAFTA Marking Rules). Under Part 102, origin is largely determined on the basis of changes in tariff classification, or tariff shifts, for the foreign materials used in the article's manufacture or assembly. The NAFTA Marking Rules can sometimes differ from the NAFTA rules of origin, and a product must meet both in order to qualify for NAFTA tariff preferences.

  The USMCA, however, eliminates the legal authority for Part 102's NAFTA Marking Rules. If U.S. Customs and Border Protection (CBP) correspondingly eliminates the NAFTA Marking Rules, it is anticipated that the general customs substantial transformation rule of origin could instead apply, in which the country of origin is the country where the product was wholly obtained or where the foreign materials used to manufacture or assemble the product were last substantially transformed into an article with a new and different name, character, or use.

- ***Drawback restrictions***

  NAFTA places restrictions on drawback (i.e. duties that will be refunded, reduced, or waived). Specifically, under NAFTA's "lesser of" rule, drawback is the lesser of the total duties paid or owed on goods when imported into a NAFTA country and subsequently exported to another NAFTA country. USMCA maintains this restriction, but expands NAFTA's sugar exception to include sugar-containing products such as beverages. Though USMCA's drawback provisions are largely identical to NAFTA, businesses may benefit less from drawback because USMCA also increases the de minimis shipment value levels. Thus more goods will be duty-free meaning that under the "lesser of" rule companies will not qualify for a drawback.

- ***Mexico's "Derecho de Tramite Aduanero" processing fee:***

  NAFTA prohibits Parties from placing specific customs user fees on originating goods, including Mexico's processing fee (Derecho de Trámite Aduanero). As a result, Mexico's customs regulations specifically exempt NAFTA imports and exports from paying this fee. This exemption will continue to apply under USMCA.

Regulatory guidance

USMCA's changes detailed above require corresponding changes in U.S. regulations. The USMCA Implementation Act, signed into law on 29 January 2020, authorizes and sets specific timelines for the issuance of these regulations.

For example, by no later than 1 July, all Parties must agree to "Uniform Regulations" setting out a common interpretation of USMCA's rules of origin and trade facilitation provisions. CBP issued Interim Implementation Instructions on 21 April 2020 to provide stakeholders with guidance until formal, final regulations can be aligned with the Uniform Regulations. The Interim Implementation Instructions provide little guidance. Thus, importers must act with reasonable care in complying with USMCA. Most of the other regulations necessary to implement USMCA's changes have a longer timetable and must be prescribed within one year after 1 July 2020 "to the maximum extent feasible."

The U.S. Trade Representative has indicated that in general it is not inclined to grant enforcement discretion during an informed compliance period while importers adjust to the new USMCA requirements. Stakeholders should therefore be prepared to comply with most USMCA provisions on 1 July 2020. Until then, all NAFTA regulations remain in place.

Other key changes under USMCA

- ***Labor investigations***

  USMCA contains the most robust labor and environment provisions of any trade agreement ever negotiated – which contributed to its strong bipartisan support. With respect to labor, specifically, USMCA also establishes a novel "rapid response labor mechanism." The mechanism permits the United States or Mexico to request that an independent panel conduct an expedited review of an alleged denial of free association and collective bargaining at specific facilities in both countries. Penalties for denying these rights include the suspension of preferential tariff treatment or complete denial of entry for goods manufactured at that facility. As part of the process, the panel can request to inspect the factory in question. Previous U.S. free trade agreements have only focused on broader countrywide or industrywide labor practices, not labor disputes at specific work places. This mechanism, which was a last minute addition at the request of House Democrats, will likely be invoked by both countries soon after USMCA's entry into force. Targeted sectors may include, but are not limited to, mining, steel, and automobiles.

- ***Intellectual property rights protections***

USMCA's intellectual property chapter is a significant expansion of the intellectual property protections provided for under NAFTA and is largely reflective of expanded intellectual property rights protections in other recent U.S. trade agreements. It is designed to strengthen the enforcement and protection of intellectual property rights, including patents, trademarks, copyrights, and trade secrets. For example, Parties cannot limit the term of protection for trade secrets and must adopt criminal penalties for misappropriation of trade secrets. Additionally, there are provisions requiring new notification systems and procedures for asserting patent rights and challenging patent validity. Other provisions expand trademark protections to sounds and scents. And USMCA requires copyright protection for at least the life of the author plus 70 years.

- ***Investor-state dispute settlement***

  USMCA will significantly change NAFTA's investor-state dispute settlement (ISDS) mechanism. First, USMCA's ISDS provisions only apply to the United States and Mexico. U.S. investors in Canada and Canadian investors in the United States will have to turn to domestic courts or other dispute settlement mechanisms. Additionally, USMCA generally restricts what type of allegations may be brought before an ISDS tribunal. The only permitted claims are those alleging (1) a breach of national treatment, (2) a breach of most-favored-nation treatment, and (3) direct expropriation. Claims for indirect expropriation and for breach of the minimum standard of treatment are excluded from ISDS. And unlike NAFTA, before turning to the ISDS mechanism, investors must first exhaust local remedies by filing in the host state's domestic courts and receiving a final judicial decision or waiting 30 months, unless it would be "obviously futile or ineffective." These substantive and procedural restrictions on ISDS claims, however, do not apply to investors with government contracts in certain sectors including: oil and gas, power generation, telecommunications, transportation, and infrastructure.

  USMCA includes a phasing-out period from NAFTA's investment protections which applies to all three NAFTA Parties. For a period of three years following the termination of NAFTA, investors may continue using NAFTA's ISDS mechanism for "legacy investments" – existing investments established or acquired between 1 January 1994 and 1 July 2020.

- ***Digital trade***

  USMCA also adds a digital trade chapter – the first of its kind for any U.S. trade agreement. The digital trade chapter effectively formalizes the free flow of data and exchange of digital services across North America, as well as lowers costs for moving data across borders. Most significantly, Canada, Mexico, and the United States agree to eliminate all customs duties on digital products. There is also a provision preventing any of the three Parties from imposing so-called data-localization requirements, which can limit cross border data flows from local data centers. This is particularly important for e-commerce vendors, for example, who need to transfer customer and commercial data across borders to keep track of orders and products. Another provision limits platforms liability for content posted on their sites by third-party users, except regarding intellectual property enforcement. USMCA also restricts governments from forcing companies to disclose source code, such as algorithms for artificial intelligence. Other provisions include commitments on transparency, consumer protection (including privacy), and cybersecurity. This chapter served as the basis for the trade deal reached between the United States and Japan last summer and is likely to be the template for future trade deals.

- ***Sunset clause***

Unlike NAFTA, which would have remained in effect indefinitely, USMCA will terminate 16 years after its entry into force, unless the Parties all agree to extend the agreement by another 16 years. The Parties will make this decision during a joint review conducted six years after USMCA's entry into force. If the Parties all agree to extend USMCA, the next joint review will not be held for another six years, at which point the parties will again have an opportunity to extend the agreement by another 16 years. However, if a Party determines that it does not want to extend USMCA during any joint review, the Parties will conduct annual joint reviews during the remainder of USMCA's term. The Parties will have an opportunity to extend USMCA by another 16 years until this term expires.

Please contact any of the listed attorneys with questions regarding USMCA's implementation.

Contacts

Kelly Ann Shaw
Partner*, Washington D.C.
T +1 202 637 5743
kelly.ann.shaw@hoganlovells.com
*Admitted only in California. Supervised by principals of the firm.

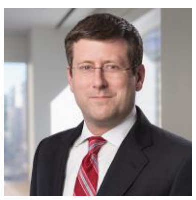
Craig A. Lewis
Partner, Washington, D.C.
T +1 202 637 8613
craig.lewis@hoganlovells.com

Chandri Navarro
Partner, Washington, D.C.
T +1 202 637 5640
chandri.navarro@hoganlovells.com

H. Deen Kaplan
Partner, Washington, D.C.
T +1 202 637 5799
deen.kaplan@hoganlovells.com

Warren H. Maruyama
Partner, Washington, D.C.
T +1 202 637 5716
warren.maruyama@hoganlovells.com

Jonathan T. Stoel
Partner, Washington, D.C.
T +1 202 637 6634
jonathan.stoel@hoganlovells.com



Jared R. Wessel
Partner, Washington, D.C.
T +1 202 637 6472
jared.wessel@hoganlovells.com

Michael Jacobson
Senior Associate, Washington, D.C.
T +1 202 637 4653
michael.jacobson@hoganlovells.com

Molly Newell
Associate, Washington, D.C.
T +1 202 637 8209
molly.newell@hoganlovells.com