

October 2018

What's in a Name – the USMCA is the New NAFTA

Late in the evening of the last Sunday in September, 14 months after President Trump triggered complex and contentious *North American Free Trade Agreement* (NAFTA) renegotiations, a new deal was announced.

On the surface, NAFTA was set aside, replaced by the *United States-Mexico-Canada Agreement* (USMCA). Look more deeply, and there's evidence that much of the substance of NAFTA remains. USMCA does change the landscape with notable new commitments but much, and in some cases surprisingly, remains unchanged.

Overall, the agreement constitutes a significant political accomplishment for Prime Minister Trudeau and his team of negotiators lead by Global Affairs Minister, Chrystia Freeland and Chief Negotiator, Steve Verheul. The renegotiation, prompted by President Trump's commitments during the 2016 presidential campaign, was a steep hill to climb for the Canadian government. Notwithstanding President Trump's threats to impose auto tariffs or, even worse, to tear up NAFTA, the deal got done because all three parties to the agreement deemed it in their economic and political interest to do so.

Notable changes affecting Canada

Increased North American content in automobiles – For an automobile to be duty-free under USMCA, 75% of the content must originate in the United States, Mexico or Canada. This is an increase from the 62.5% threshold under NAFTA. The increase under USMCA in effect requires a higher amount of processing operation and

manufacturing of a product to determine its national origin. Further qualification has been added to this North American content in USMCA's Chapter 4: at least 40% of the automotive value will need to be made by workers earning at least US\$16 per hour. This requirement has significant effects for all USMCA parties. Certain Mexican workers will likely be paid more, and the analysis of where in North America is most efficient to locate an automotive production facility can change dramatically.

Some protection against auto tariffs – President Trump has threatened to impose tariffs on imported automobiles under s. 232 of the *Trade Expansion Act*. Under USMCA (including the integral side letters), if the US moves ahead with such global auto tariffs, Canadian and Mexican exports to the US will each receive exemptions for 2.6 million passenger vehicles annually, all light trucks, and a certain dollar value of auto parts (US\$32.4B from Canada and US\$108B from Mexico). These exemption levels for passenger vehicles and parts are significantly higher than current levels. These exemptions would therefore meaningfully avoid disruption of the North American auto supply chain, at least for the immediate future.

The auto provisions of the deal are, at their core, essential for all three countries. Hundreds of thousands of jobs were at stake in an industry that is integral to the North American manufacturing sector. Disrupting a highly integrated, sophisticated supply chain would have been tremendously harmful.

Increased US access to Canadian supply managed sectors (dairy, poultry and eggs) – Canada's supply management system will continue to exist, but greater levels of US access will be permitted. Dairy was a very contentious issue and under USMCA the US has obtained preferential access to about 3.6% of Canada's dairy market. This follows the additional preferential access Canada recently granted to its partners under the *Comprehensive and Progressive Trans-Pacific Partnership* (CPTPP) of 3.25%, and preferential access granted for European cheese permitted under the

Comprehensive Economic and Trade Agreement (CETA).¹ In addition, Canada's "Class 7" component of its dairy supply management system, which covers dried milk products, will be removed and no longer protected. Finally in comparison to the CPTPP, Canada will allow the US almost more than double the access to Canada's poultry market and almost triple the access to Canada's egg market.

Dairy farmers in Alberta, Quebec and Ontario are upset at losing market share. But, the Canadian institution of supply management has been preserved and Canadian consumers will continue to subsidize the politically powerful dairy community in the form of higher prices for dairy products and federal funds that will be made available to dairy farmers as compensation for lost market share.

Increased *de minimis* importation thresholds – One perceived obstacle for US e-commerce vendors was that any shipments to Canada worth more than C\$20 were subject to duty and sales taxes. Canada will increase its thresholds so that shipments worth C\$150 or less will be exempt from duties and shipments worth less than C\$40 are exempt from sales taxes. Organizations representing Canadian retailers will begrudge this increased competition (and in some ways, their own competitive disadvantage), but the increased threshold will be welcomed by millions of consumers seeking deals from merchants south of the border.

Longer protection of intellectual property – The changes improve Canada's alignment with the US. Under USMCA's Chapter 20, the life of most copyrights will last until 70 years after the death of the author, which is 20 years longer than under current Canadian law. Also, patent protection for biologic pharmaceuticals (which are derived from living organisms and are often very expensive) will be extended from eight to 10 years.

No more investor-state dispute settlement between the US and Canada – Investor-state dispute settlement (ISDS) has been a contentious topic in some recent free trade agreements, even though

¹ For more information about CETA, see one of our previous bulletins: *CETA Carves Out More than just European Cheese and Canadian Beef* (January 2018); for more information about the CPTPP, see *The Comprehensive and Progressive TPP – Countering The Pressures for Protectionism* (January 2018)

there are over 3,000 bilateral investment treaties around the world that contain such protections for foreign investors. For example, ISDS provisions of CETA are not yet in force due to the objections of some European states. ISDS enables certain foreign investors to sue host governments for alleged discriminatory treatment, treatment that falls below a minimum standard of "fair and equitable" treatment or uncompensated expropriation. Although no ISDS claims were ever successful against the US under NAFTA, Canada and Mexico were both on the receiving end of dozens of claims. Some of these claims were found to be meritorious by international arbitral tribunals and resulted in substantial compensation to US investors. Despite these benefits of ISDS to the US, this form of supranational adjudication was a target of the Trump Administration and the Canadian government agreed to its elimination. After a three-year transition period for legacy investments made under NAFTA, the ISDS mechanism will no longer be available between Canada and the US under USMCA. A more limited form of ISDS between the US and Mexico will remain. Canada and Mexico will still have an ISDS mechanism when the CPTPP agreement enters into force.

Canada does not provide any constitutional protections for property rights and its courts tend to be more deferential to administrative actions than those in the US. As a result, NAFTA's ISDS provisions have occasionally been an important backstop for US investors who have been subject to unfair treatment by provincial or federal governments. US investors in Canada with potential claims arising from the actions of Canadian governments should review their potential NAFTA remedies before USMCA enters into force.

Review mechanism and duration of agreement – A review mechanism will be triggered after six years under USMCA; it provides for potential 16-year extensions of the agreement. Under NAFTA, the agreement remained in force until the parties withdrew. The US had proposed that the agreement would terminate after five years unless all parties agreed to extend it. That Canada managed to secure this comfortably long sunset timeline is an accomplishment worth noting, if only because President Trump publicly promoted a five-year period.

Required notice to negotiate a free trade deal with a “non-market country” – USMCA requires Canada, the US and Mexico to provide notice if they plan to negotiate a free trade agreement with a “non-market country”. A “non-market” country is defined in article 32.10 as “a country that on the date of signature of this agreement at least one Party has determined to be a non-market economy for purposes of its trade remedy laws and is a country with which no Party has a free trade agreement”. Three months prior to starting negotiations, the other countries must be officially informed with “as much information as possible” including the negotiation’s objectives. Further, notice must be given to the other two countries at least one month prior to signature, to review the agreement. If a country enters into such an agreement, the other two reserve the right to terminate USMCA vis-à-vis the first country on six month’s notice, and a bilateral version of the USMCA will come into force between the remaining parties. This is distinct from any party’s right to withdraw from USMCA completely for any reason on six months’ notice under article 34.6

Indigenous exemption to recognize and respect treaty rights and obligations – Although there is no standalone chapter as advocated by Canada, USMCA’s Chapter 32 on “Exceptions and General Provisions” contains an Indigenous exemption that states “nothing in this Agreement shall preclude a party from adopting or maintaining a measure it deems necessary to fulfil its legal obligations to Indigenous peoples.” This provision appears to exempt Indigenous-related litigation, policy decisions and funding from USMCA’s obligations.

Removal of British Columbia’s wine sale restriction - In the *US-Canada Side Letter on Wine*, Canada commits the British Columbia (BC) government to removing its rules that prevent non-BC wine from being sold in regular grocery stores. The US had previously requested a panel arbitration at the World Trade Organization (WTO) to remove the provincial government’s sale policy. This side letter appears to make that WTO dispute moot.

Notable non-changes relating to Canada

Steel and aluminum tariffs – USMCA does not resolve the dispute over US tariffs on steel and aluminum imports from Canada and Mexico, or the retaliatory tariffs that each country placed on them.² There were high hopes that a new NAFTA would exclude Canada and Mexico from such tariffs, or offer some other compromise such as reasonable import quotas. None of that happened and the tariffs, and Canadian/Mexican retaliatory tariffs, remain. This is a sore point for the Canadian government, not to mention for our steel and aluminum producers. However, the Canadian government has pledged to build on the momentum of the trade deal and work toward a beneficial resolution of the problem.

Dispute resolution relating to anti-dumping and countervailing trade remedies – NAFTA's Chapter 19 dispute resolution mechanism allows independent panels to review trade remedy decisions affecting NAFTA companies. Canada's insistence on the importance of this mechanism was a major sticking point in negotiations. At the end of the day, it will continue with minimal changes in USMCA. Many regard this as a concession by the Americans and a *quid pro quo* for dairy market share protection that was given up by Canada to American dairy farmers in Wisconsin and New York.

Government procurement – Canada had sought access to sub-national public procurement in the US (such as at the state or municipal government level). Under USMCA's Chapter 13, when states and other sub-national public entities are procuring, they are still able to limit contracts to US companies or require minimum levels of US content (including "Buy America" contractual requirements).

Canadian cultural exemptions – Canada's exemptions regarding cultural industries, including film, broadcasting and publishing, remain unchanged from NAFTA in USMCA's Chapter 32.

² For additional information on this issue see *Surtax! What To Do Now* (July 2018) and *Tit for Tat* (June 2018).

Next steps

The time lag between a trade agreement being signed and coming into force can be significant. The text of USMCA needs to be translated into French and Spanish, and a full legal review needs to be completed. The parties also need to ratify the agreement (which will involve or require the approval of legislative bodies, including the Parliament of Canada and the US Congress). Legislation implementing the agreement will also need to be drafted and passed. This whole process could take 12 to 18 months. Unlike CETA, USMCA does not have any “provisional” implementation mechanism to allow portions of the agreement to take effect prior to full implementation. Also, numerous provisions of the agreement have meaningful transitional periods to help businesses adapt to the new obligations. Until USMCA is implemented, NAFTA will remain in force.

There are certain risks inherent in the ratification process. While the new Mexican government has pledged to support the deal, US midterm elections in November could produce a reconfigured Congress that is more heavily weighted in favour of Democrats. If labour and environmental provisions contained in USMCA are deemed inadequate by major American unions, the deal could face significant obstacles in the House or the Senate.

In Canada, there are aspects of the deal that will require legislation for the purpose of implementation. So long as these are dealt with during the life of this Parliament, a Liberal majority in the House of Commons virtually guarantees passage. However, the Senate of Canada is a wild card and it is conceivable that the upper house could throw obstacles in the path of the implementation process.

On a final note, businesses (and their advisors) should exercise diligence and care in reviewing the actual agreement with their specific circumstances in mind. Language matters, and in this case, industry-specific knowledge and appreciation for nuance is integral to understanding the implications of this deal for your business.

by Jonathan O’Hara, Robert Wisner and Mark Resnick

For more information on this topic, please contact:

Ottawa	Jonathan O'Hara	613.691.6176	jonathan.ohara@mcmillan.ca
Toronto	Robert Wisner	416.865.7127	robert.wisner@mcmillan.ca
Ottawa	Mark Resnick	613 691 6148	mark.resnick@mcmillanvantage.com

[a cautionary note](#)

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