

LET THEM ROLL: DISPUTE SETTLEMENT PANEL RULES IN FAVOUR OF CANADA AND MEXICO ON AUTOMOTIVE RULES OF ORIGIN AND “ROLL-UP” METHOD UNDER CUSMA

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Overview

In a report circulated on January 11, 2023, a dispute resolution panel established under the Canada-United States-Mexico Agreement (“**CUSMA**”) sided with Mexico and Canada against the United States in respect of automotive rules of origin. The panel found that the US requirements for calculating regional value content (“**RVC**”) for passenger vehicles and light trucks are in breach of CUSMA’s rules of origin.^[1] In siding with Mexico and Canada (and a significant portion of the automotive industry), the panel confirmed that CUSMA allows vehicle manufacturers to “roll-up” the cost of originating core parts. The US is expected to bring itself into compliance with the panel’s ruling, thereby allowing for freer trade in the North American automotive market. Absent such compliance, Mexico and Canada would be legally entitled to retaliate against the US by imposing duties or otherwise taking measures of equivalent effect.

This is the third panel decision to be issued under Chapter 31 of CUSMA. For an overview of other disputes, see McMillan’s CUSMA Dispute Settlement Scoreboard [here](#).

The Law: CUSMA’s Rules of Origin and Roll-up

CUSMA contains complex “rules of origin” for determining whether a vehicle originates in a CUSMA Party, thereby entitling it to preferential tariff treatment. Under those rules, 72% of the value of finished passenger vehicles and light trucks must originate in a CUSMA Party.^[2] CUSMA also requires 72% of the value of core parts to originate in a CUSMA Party,^[3] but permits the use of more flexible methods for calculating the RVC of core parts than it does for calculating the RVC of the finished vehicle. The RVC requirements for both finished vehicles and core parts will increase to 75% on July 1, 2023.

Roll-up occurs when a producer considers 100% of the value of an input as originating in a CUSMA party, even if that input is comprised of some non-originating material. Consider a car engine. If that engine is made from 85% North American components, it qualifies as an originating “core part” under CUSMA. When that engine is

incorporated into a finished vehicle, the roll-up method would consider 100% of its value to be North American, not just 85%. In the words of the panel, the producer disregards the value of the non-originating inputs in the finished vehicle RVC calculation.^[4]

The Dispute: the US' Requirement not to Roll-up for Approval of ASRs

The present dispute arose as a challenge to the US policy of effectively precluding automotive producers from applying the roll-up technique for core parts, making it more difficult for them to qualify for preferential tariff treatment. The US implemented this policy through certain importation agreements – termed Alternative Staging Regimes (“**ASRs**”) – that allow producers to import passenger vehicles or light trucks under a different set of requirements than those contained in CUSMA.^[5] The US informed producers it would approve ASRs on condition that they not use the more flexible methods for calculating the RVC of core parts and then roll up the entire value of those core parts in the finished vehicle RVC calculation. Mexico and Canada argued that such a condition was inconsistent with CUSMA’s roll-up provision, namely Article 4.5.4.

The Decision: Let Them Roll

The panel held in favour of Mexico and Canada, clarifying that the entire value of originating core parts could be rolled-up in the vehicle RVC calculation. This was because, in the panel’s view, the term “originating” should be interpreted consistently throughout CUSMA: once a core part is “originating”, even under the more flexible methodologies for calculating RVC, it is then “originating” for the finished vehicle RVC calculation.^[6] Not only was this consistent with principles of treaty interpretation, it was also the position of US negotiators, as evidenced by communications they exchanged with Canada during CUSMA’s negotiation.^[7]

The Impact: Clarity on Freer Trade in the Automotive Sector in North America?

Now that the panel has issued its decision, the US, Mexico and Canada have 45 days to reach a resolution, and for the US to bring itself into conformity with CUSMA, meaning the US would have to cease denying ASRs on the basis that a producer used the roll-up method to calculate RVC for core parts. Alternatively, if the US does not bring itself into conformity, Canada and Mexico could legally retaliate against the US, and could target its automotive sector.

Should the US eliminate its non-conforming measure, it would mean more vehicles produced in Canada and Mexico would qualify for duty-free access under CUSMA. In short, freer trade and greater access to the American market for vehicles assembled in Canada and Mexico. On the other hand, and taking the view of the US, the decision could mean less North American content ultimately ends up in vehicles traded between the parties.

The decision is a welcome one for Canada and Mexico’s automotive industries, which have faced challenges

stemming from the effects of COVID-19 and supply chain breakdowns, including factory shutdowns and semiconductors chip shortages. The panel's reasoning also provides a degree of clarity on the legal interpretation of CUSMA that could be persuasive to future panels: the term "originating" has a consistent meaning throughout CUSMA unless otherwise modified by its text.

[1] *United States – Automotive Rules of Origin* (USA-MEX-CDA-2022-31-01), Final Report, December 14, 2022 ("**Decision**").

[2] The parties raised this from 62.5% under NAFTA. For more on the changes in CUSMA see our previous commentary [here](#) and [here](#).

[3] Core parts are listed in Table A.1 of the Autos Appendix to Chapter 4 and include the engine, transmission, body and chassis, axle, suspension system, steering system and advanced battery. CUSMA also establishes the categories of principal parts and composite parts, which have their own RVC requirements.

[4] Decision, para. 51.

[5] ASRs are transitional instruments required under CUSMA. They can be used until July 1, 2025.

[6] Decision, para. 149.

[7] Decision, paras. 190-192.

by [Jonathan O'Hara](#), [William Pellerin](#), [Philip Karam](#), [Tayler Farrell](#) and [Adelaide Egan](#) (Articling Student)

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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