

The USMCA-Ten Things to Keep in Mind for Companies in Mexico

🕒 Feb 13, 2019 Top Ten

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Introduction

After more than one year of negotiations, the "U.S. Mexico Canada Agreement" ("USMCA"), a new trade agreement that will replace NAFTA ("North American Free Trade Agreement") has been reached by the presidents of the U.S., Mexico, and the prime minister of Canada. The Agreement was recently signed on November 30th, 2018 (in Buenos Aires, Argentina, during the G-20 Meeting), and would become effective on the first day of the third month that follows the last notification of its ratification.

This trade deal is expected to bring benefits to the three countries (in terms of employment growth, sales/market increases, and financial stability, among other positive effects). All actors need to be aware of the changes introduced by the agreement, the new benefits that can apply to them, the new requirements they need to comply with, and the foreseeable amendments to domestic laws and regulations to adapt to the new rules.

The purpose of this article is to list the ten most important matters to in-house counsel that have impact in Mexico (and on its domestic and foreign investors) as result of the USMCA.

1. Good News for Express Delivery companies - De Minimis Thresholds

The following new rules apply only to goods purchased online and shipped by "express shipments" (e.g. FedEx, UPS, DHL). State entities, like the United States Postal Service, Canada Post and Servicio Postal Mexicano, are excluded.

§ *Canada's De Minimis threshold was raised* – Canadian consumers will not have to pay import duties on products that are \$150 CAD or less (raised from \$20 CAD). The Canadian GST/HST/PST will apply from \$40 CAD (raised from \$20 CAD).

§ *Mexico's De Minimis threshold was also raised* – The USMCA establishes the increase of the duty free de minimis threshold to \$100 USD for importing goods free of customs duties and taxes. That limit was raised from \$50 USD.

§ *USA's De Minimis threshold is expected to remain the same* – The USMCA sets forth a minimum amount of at least \$100 USD for products imported into the U.S. However, the expectation is that the U.S. will continue applying the amendments to the Trade Facilitation and Trade Enforcement Act. The amendments increased the value of a shipment to be free from duties and taxes to \$800 USD.

2. Some Changes in Rules of Origin Verification Procedures

§ The format of the certificate of origin is eliminated and it is allowed that the certification of origin is made with the commercial invoice or any other commercial document. It is sufficient that certain minimum information is included, adding a detailed description of the goods that allows their identification and the declaration that they are originating and comply with the [requirements of the applicable rule of origin](#).

§ It will be also possible for the certification of origin to be made not only by the producer or the exporter, but by the importer. Before, the certificates needed to be issued by the producer or the exporter of the goods. Now, it is permitted that the importer of records issues the certification for its own importations.

§ If the certification of origin of the goods was issued by the producer or the exporter, the preferential tariff rate treatment to the importer cannot be denied, if previously, the customs authority has not issued a written questionnaire or initiated audit visits to the exporter or the producer. It is important to mention that there are no public records about the audits or questionnaire procedures being conducted by the authorities. The import always relies on the representations and warranties of the exporter and/or producer about the origin of the goods. Therefore, it is always important that the importer has sufficient protection, from a contractual perspective, to cover itself against misrepresentations and the possible tax and customs penalties that can be imposed.

3. Good News for Agriculture Products

§ [Agricultural seasonality initially proposed by the U.S. was not included in the Agreement](#). In general terms, agricultural products were free of tariffs (under the NAFTA). During the negotiations, the U.S. wanted to include provisions to impose import tariffs and taxes in its territory on certain goods during certain seasons of the year. At the end, this provision was not included in the USMCA.

§ As general rule, imports of agricultural products originating from Mexico, the U.S. or Canada will remain exempt.

§ The Agreement includes a section regarding biotechnology, which promotes the innovation in this sector (among others, broader and major [protection for patents](#) and appellation of origin).

§ Also, it was agreed not to subsidize exports, nor [apply safeguard measures](#) issued by the World Trade Organization.

4. New Game Rules for the Automotive Industry (vehicles) I

§ NAFTA used the notion of Regional Value Content ("RVC"), which is a coefficient ([calculated according to formulas described in the NAFTA and the USMCA](#)) used to determine whether a good qualifies as originating. Under the USMCA, RVC was increased for the production of light vehicles from 62.5% to 75%, using the net cost method. This increase will be gradual for a period of three years.

§ RVC was also increased for the production of heavy vehicles from 60% to 70%, using net cost method. This increase will also be gradual.

§ It was approved that automotive companies shall buy at least 70% of the steel and aluminum from the region.

§ The U.S. offered an exemption to the Mexican exports of light vehicles against future tariff rates which may be imposed due to national security issues, under the terms of the rule 232.

§ The transition period for manufacturing plants for "new" vehicles is maintained. This period is of 5 years, subject to the

compliance of 50% of RVC.

5. New Game Rules for the Automotive Industry (vehicles) II - Labor content

§ The USMCA introduces the rule of "Labor Value Content" ("LVC"). Under the rule of LVC, a regional wage index was established, which requires that, in terms of value, 40% of the content of light vehicles and 45% of the content of pick-up trucks, are manufactured in regions with an average salary above \$16 USD per hour. The LVC is comprised of two items: (i) Materials and manufacturing costs (25% for cars y 30% for pick-up trucks); and (ii) Investigation and Development (I&D), Information Technology services, and motor, transmission or advanced batteries assembly operations (15%).

§ This will be applicable for any vehicle.

6. Also New Game Rules for Auto Parts Industry

§ Spare parts were divided into three categories, each one with different RVC levels, and all the three with an implementation term of three years:

- o (i) Core: 75% of the RVC under the net cost method, or 85% under the transaction value method, if applicable;
 - o (ii) Principal: 70% of the RVC under the net cost method, or 80% under the transaction value method, if applicable; and
 - o (iii) Complementary: 65% of the RVC under the net cost method, or 75% under the transaction value method, if applicable.
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7. Important Considerations for Investors regarding Dispute Settlements

This chapter only applies between Mexico and U.S. The Investor State Dispute Resolutions ("ISDS")** disappeared between the U.S. and Canada. For disputes between Canada and Mexico, the countries can apply the ISDS of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("CPTPP").

§ General Scheme ("Skinny ISDS") – A Mexican or US investor may file a claim through arbitration for breaches by the respondent State (Mexico or US) exclusively in relation to: (i) national treatment; (ii) most favored nation, except in relation to the establishment or acquisition of an investment, and (iii) expropriation and compensation, except as regards to indirect expropriation. However, before arbitration, investors must exhaust local remedies before a competent court of the respondent State.

§ Special Scheme ("Covered Sectors") – Expanded and more favorable regime in the case of government contracts covered in the following sectors: (i) oil and natural gas, (ii) energy generation services, (iii) telecommunications, (iv) transportation, and (v) infrastructure. In these cases, the US or Mexican investor may submit to arbitration a dispute against the respondent State, when said State has breached any of its investment obligations.

§ Transitory Regime – Investment-related claims initiated under NAFTA Chapter XI, that are pending at the time of entry into force of the USMCA, may follow their course and conclude in accordance with the provisions of NAFTA. Claims related to an investment established or acquired between January 1st, 1994 and the date of termination of the NAFTA, and that continue to exist on the effective date of the USMCA, may be resolved through arbitration in accordance with the provisions of NAFTA. This, provided that the claims are filed within the following three years as of the termination date of NAFTA.

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** This is a system created to settle disputes between the private investors of the country of one of the parties, and the government of the country of another party. NAFTA included a Chapter applicable for the U.S., Canada and Mexico. In case of dispute, the resolution was through international arbitration. ISDS under the USMCA only applies between Mexico and the U.S. For disputes between Canada and the U.S., the parties need to seek relief in the local countries of the defendant.

8. Important Changes in the Rules of Origin of Specific Sectors

The USMCA includes Exhibits with [specific rules of origin for products of the industries and sectors listed below](#). Just like for the automotive industry, the actors and parties need to review the changes, and implement important measures to qualify to the tariff benefits and maintain competitive prices.

§ Information technologies and communications.

§ Pharmaceuticals.

§ Healthcare products.

§ Cosmetic products.

§ Chemicals.

§ Energy performance standards.

Changes include additional requirements to comply with the RVC, and recognition of the invention of formulas, know-how, design and research as part of the origin components.

9. Important Changes Expected for Mexican Domestic Labor and Employment Law

This chapter requires significant changes to Mexico regarding collective bargaining relationships. USMCA requirements go in hand with the amendments to the Mexican Constitution of February 2017 and the recent ratification by Mexico of the 98th Convention of the International Labor Organization.

§ A Chapter called "Labor" is included, which requires compliance with fundamental labor rights, and promotes the transparency in the application of labor laws.

§ The Agreement includes an annex regarding the representation of workers in collective bargaining agreements, on which Mexico undertook to legislate to guarantee the effective recognition of this right.

§ The parties agreed to adopt and maintain the rights recognized by the International Labor Organization, as well as to comply with labor laws and not waive or repeal those laws.

10. Things to Keep in Mind about the USMCA

§ The "sunset" clause proposed by the US was eliminated, which proposed the termination of the agreement every five years, subject to renegotiation.

§ Minimum validity of 16 years, with review processes every six years.

§ During the reviews, the extension of the USMCA may be agreed for additional periods of 16 years.

§ Withdrawal from the USMCA will be effective six months after one of the parties notifies the others in writing. If one of the parties withdraw, the USMCA will remain in force between the other two parties.

§ Any possible modifications to the World Trade Organization rules and provisions (for example, in connection to tariffs, import regulations, safeguard measures, etc.) will not automatically affect the USMCA.

RISKS, OPPORTUNITIES AND RECOMMENDED ACTIONS

There is a new game in international trade. In addition to the USMCA, we have the CPTPP, the U.S.-China trade tension, and the new trade deal between Mexico and the European Union. Things are rapidly changing. The key word is "prevention". Companies should start implementing significant actions to verify they are in compliance with the USMCA and the changes to come in domestic laws. For example:

§ Rules of origin and customs laws – Start internal audits to verify level of compliance, identify red flags and implement action items.

§ Contractual Support in Import-Export operations – Most of the companies do not pay attention into the contractual documents of international transactions. Purchase Orders are not contracts. If the exporters or producers fail to comply with customs regulations, the importer can be subject to tax assessments in its jurisdiction. Therefore, it is important to confirm there is proper contractual support for the import-export operations.

§ Labor and Employment – For companies with investment in Mexico, it is very important to follow the imminent changes to come in connection to collective bargaining agreements, unions, minimum salaries, and employment benefits, and start implementing organizational changes.

§ Automotive Industry – More value content is required. Companies need to redesign their supply chain, origin of raw materials, and manufacturing process to continue benefiting from the preferential tariffs.

It is very important to act now. The USMCA may not be effective yet and perhaps changes to domestic laws have not been approved as well, however, the ratification of the treaty looks like something of only about time. Therefore, we could say that the playing field has been set up in international trade for the new game to come.

CONCLUSIONS

After many months of uncertainty, the new trade deal provides legal certainty to economic agents, and eliminates commercial and exchange rate volatility. Yes, things have changed, introducing stricter rules. The wall to access to the region benefits is now higher (as products need to comply with more complex rules of origin in certain products to have access to the benefits of the USMCA). Investors and companies need to adapt to the new circumstance to continue benefiting from the trade deal benefits. In that sense, companies will need develop a planning methodology to correctly comply with the Rules of Origin and will need to review:

§ The financial impact on value chain and a supply chain to obtain the established benefits for some industries (i.e. autos, textiles, agriculture, polymers, and chemicals) in the USMCA.

§ New information and requirements need for the certification and qualification of origin.

§ The specific classifications of rates and costs applicable to obtain the benefits of the UMSCA.

§ Contractual terms and identification of gaps and risks compliance.

§ The labor and regional content to comply with the new percentages of the UMSCA.

§ The modifications in the manufacturing processes and the supplier relationship management and its possible impact.

Also, the obligations assumed by the parties may lead to important changes in domestic laws (e.g. Mexican domestic labor laws, and IP, Anticorruption and Environmental regulations in the three countries). This may all be seen as disruptive, and in some cases, not beneficial for the already existing chain of production. However, another perspective, more positive and challenging is that, when things change, the situation forces stakeholders to be creative and more competitive.

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