The Amended USMCA: Six Takeaways for Business

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The Protocol of Amendments (USMCA Amendments) to the new North American free trade agreement signed by Canada, Mexico, and the United States on December 10, 2019 makes important changes to the USMCA (or CUSMA as Canada prefers to call it) originally signed in November 2018. The USMCA Amendments, made at the insistence of U.S. House Democrats, cover:

- Labour and environmental protection;
- State-to-state dispute settlement;
- Intellectual property; and
- Rules of origin for automotive goods.

Our analysis of the original 2018 USMCA text is available here. In this note we discuss six things that Canadian businesses need to know about the amendments, including what they change and what they don't change. In summary, the USMCA Amendments:

- Will make it more difficult for North American-made motor vehicles to qualify for duty-free treatment;
- Will no longer require Canada to change its intellectual property laws for pharmaceuticals;
- Restore a functioning state-to-state dispute settlement mechanism;
- Leave "Chapter 19" dispute settlement vulnerable;
- Do not address outstanding digital trade issues such as a digital services tax; and
- Make it likely that the USMCA will enter into force in spring, 2020.

Here are the key details and our analysis of these outcomes:

1. They make it harder for North American-made motor vehicles to qualify for duty-free treatment, particularly for U.S. imports into Canada or Mexico, and vice versa

The rules of origin in the USMCA govern which goods can be imported duty-free into Canada, the United States or Mexico. The USMCA significantly tightens up the rules of origin for automotive goods compared to the NAFTA, including a requirement that 70

per cent of steel and aluminum purchased by producers of passenger vehicles and light and heavy trucks must qualify as originating in the USMCA region for their vehicles to qualify as originating.

The USMCA Amendments further tighten up these rules by requiring that, beginning seven years after the USMCA enters into force, steel will be originating only if all of the manufacturing processes (except for some metallurgical processes) occur in one or more of the Parties. While raw material inputs, such as scrap or iron ore, will still be able to be imported from outside the USMCA region without affecting the origin of the steel, all manufacturing from melting and pouring forward will have to take place in Canada, the United States or Mexico for the steel to qualify toward the 70 per cent requirement. By contrast, no equivalent new requirements were included for aluminum, an industry in which Canada has a clear competitive advantage over the United States and Mexico, and where Canadian exports to those countries have suffered as a result of imports from outside of North America. The Amendments commit the Parties only to "consider" additional requirements for aluminum ten years after the USMCA enters into force.

More stringent rules of origin are likely to increase the cost of vehicle production in North America. It will be interesting to see how vehicle producers adapt to them and to what extent they choose to forego USMCA tariff preferences in order to remain competitive. For example, vehicle producers may find that it is more advantageous to pay the 2.5 per cent MFN duty rate on automobile imports into the United States (but not the 25 per cent rate on trucks) than to comply with the USMCA's rules of origin.

The costs of USMCA origin compliance are likely to benefit imports into Canada from Mexico (which can qualify for preferences – and thus avoid Canada's 6.1 per cent duties on vehicles – under the more liberal rules of origin in the Trans-Pacific Partnership (TPP) Agreement). The costs also are likely to benefit imports from Japan, Korea and the European Union, which can qualify for duty free access under the more liberal rules in the TPP Agreement, the Canada-Korea Free Trade Agreement and the CETA, respectively.

2. They mean that Canada no longer needs to extend intellectual property protections for pharmaceuticals

The USMCA Amendments make several changes to the obligations on patent protection in the Intellectual Property chapter (Chapter 20) of the USMCA and in particular, the obligations on patent protection for pharmaceuticals. These changes include:

- Eliminating the requirement that Canada and Mexico had to give ten years of regulatory data protection to biologics (including biologic drugs), which would in Canada's case be an increase from the eight years' protection currently granted under Canadian law;
- Giving each Party more flexibility to limit patent term adjustments; and
- Removing provisions that would have required the availability of patents and data protection for new uses of existing drugs.

Provincial governments looking to reduce health care costs and a Canadian federal government contemplating a national pharmacare program will welcome the changes,

expected to facilitate earlier market access for generic and biosimilar drugs. The changes, however, come at the expense of the research pharmaceutical sector.

3. They revive state-to-state dispute settlement at a critical time

The dispute settlement mechanism for trade disputes between NAFTA Parties has been paralyzed for almost 20 years because the responding country in a complaint has been able effectively to block the formation of a panel. Although the 2018 USMCA text would have improved the situation, it still would have left opportunities for a Party to prevent dispute settlement panels from being formed. Now, to address concerns about the enforceability of the USMCA's labour and environment obligations (which, unlike those that accompanied the NAFTA, are enforceable through the regular state-to-state dispute settlement mechanism) the Protocol has further streamlined the dispute settlement process and eliminated the ability to block panels.

While this undoubtedly will add teeth to the USMCA's labour and environmental obligations, the biggest beneficiary of a functioning dispute settlement system will be businesses facing various trade barriers in another USMCA Party, because those businesses will be able to petition their home government to take action under the USMCA's state-to-state dispute settlement mechanism.

The revival of a state-to-state dispute settlement in a North American context is particularly welcome at a time when the World Trade Organization's dispute settlement system has been crippled by the United States' refusal to allow appointments to the WTO's Appellate Body. Even when the WTO's dispute settlement system is fully operational, the USMCA system, which has no appellate review, is designed to be significantly faster than the WTO dispute settlement system and should become the forum of choice for most state-to-state disputes where USMCA obligations are at issue even if a similar complaint could be made at the WTO.

4. They do not protect Chapter 19 dispute settlement

Many of the trade disputes between Canada and the United States, including the biggest of all, softwood lumber, involve the imposition by one Party, typically the United States, of anti-dumping or anti-subsidy (countervailing) duties, on the goods of the other. Canada fought hard in the USMCA negotiations to preserve NAFTA's Chapter 19, which allows affected companies and governments to challenge final determinations relating to anti-dumping or countervailing measures before binational panels rather than in the courts of the Party imposing the measures. However, while the preservation of Chapter 19 dispute settlement has been touted as a signature accomplishment of the Canadian government in the USMCA negotiations, it may prove to be a hollow one.

While the USMCA Amendments bolster the state-to-state dispute settlement mechanism as described above, it makes no similar or comparable improvements to the Chapter 19 process. Panel formation under Chapter 19 (now part of Chapter 10 in the USMCA) remains dependent on the good faith of the Parties and vulnerable to delays by the responding Party in nominating panelists and the objectivity of those nominees. Both of these are problems that Canada has experienced in the current softwood dispute. While

there are steps that the Parties could take to address these problems – steps that involve the procedural rules for the panel process and do not require further changes to the USMCA text – absent those changes it is difficult to conclude that the binational panel process will remain a reliable tool for businesses and governments, particularly Canadian ones.

5. They do not address outstanding digital trade issues

Unlike the NAFTA, which was negotiated in the pre-internet era, the 2018 USMCA text includes a chapter on "Digital Trade". That chapter largely follows the model established by the TPP Agreement's chapter on "Electronic Commerce" and includes, subject to exceptions for privacy measures, a prohibition on data localization requirements as a condition of doing business in a Party. One important difference from the TPP model is that the USMCA text includes a provision reflecting Section 230 of the U.S. *Communications Decency Act*, which provides protection to internet service providers in respect of content made available by users of their services. There had been some expectation that this provision would be removed by the December 10 amendments but it was not.

The amendments also do nothing to address the looming conflict over digital tax policies that seek to tax multinational companies on revenue generated by the digital services they deliver in a country's territory. Some of the non-discrimination provisions in the USMCA's Digital Trade and Cross-Border Trade in Services chapters might apply to such a tax but any consensus between Canada and the United States on what sort of digital tax is permissible probably will have to await the outcome of ongoing multilateral efforts such as that at the OECD. This is significant because the Canadian government recently confirmed plans to move ahead with such a tax, effective April 1, 2020, despite the United States' threats to impose punitive tariffs on French goods in response to a similar tax adopted by France this year.

6. They mean that the USMCA is likely to enter into force by spring 2020

The USMCA will enter force on the first day of the third month after each Party has notified that it has completed its ratification procedures. Mexico has already ratified the amended USMCA, although it is now expressing concerns about provisions in the U.S. implementing legislation addressing Mexico's compliance with its labour commitments. Now that House Democrats are largely on side and Senate Republicans, despite some misgivings about the amendments, mostly remain supportive of the deal, U.S. implementation of the legislation appears likely to move quickly through Congress. Canadian implementation of the legislation is likely to pass as well when Parliament reconvenes in January. Therefore, while some delays may be inevitable, the USMCA could enter into force as early as April 1, 2020.

Until then, the NAFTA will remain in force. Even after the USMCA enters into force, its transitional provisions provide that claims for preferential tariff treatment made while the NAFTA was in force will continue to be governed by the NAFTA. Binational panel reviews will continue under NAFTA Chapter 19 for any final determinations published by a Party before the entry into force of the USMCA.

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