

Legal update

NAFTA rebranded and updated: maintaining, protecting and preserving free trade

October 2018

International trade

NAFTA's replacement (rebranded as the US-Mexico-Canada Agreement or USMCA), was announced late Sunday. It includes some significant updates to the 25-year-old trade agreement between the three countries, but for the most part, it maintains, protects and preserves North American free trade and, in particular, Canadian trade with the United States, which was Canada's main objective. Of note:

- Chapter 19 dispute resolution provisions of importance to Canada were preserved;
- the investor-state dispute resolution system between Canada and the US was dissolved;
- Canada made concessions on dairy and agriculture;
- Mexico and the US compromised on rules of origin for the auto sector, among other things;
- the USMCA does not deal with the future of US tariffs on imports of Canadian steel and aluminium products imposed under the national security provisions of the US *Trade Expansion Act of 1962* (TEA), nor does it address the Canadian counter-measures.

Here is a breakdown of the key aspects of USMCA:

Chapter 19 Dispute Resolution

The dispute resolution provisions formerly contained in Chapter 19 of NAFTA have been incorporated into Chapter 10: Trade Remedies of the USMCA. Canada pushed to preserve these provisions, which provide for review of antidumping or countervailing duties by an independent, binational panel of trade experts rather than by the national court of the alleged offending country. Canada has used these provisions in the past to challenge US actions in relation to aircraft and softwood lumber. Under the USMCA, this dispute settlement mechanism will be available only as between the US and Canada.

Investor-State Dispute Resolution

The investor-state dispute resolution provisions of Chapter 11 of NAFTA (also known as ISDS) will not be maintained as between the US and Canada, though the USMCA will include provisions for the arbitration of certain types of

investment disputes to apply as between Mexico and the US. The NAFTA parties' consent to the arbitration of "legacy investment" claims will expire three years after NAFTA is terminated.

Pursuant to the provisions of the former Chapter 11, an investor could submit a breach of the NAFTA investment provisions to an impartial arbitration tribunal through Chapter 11's ISDS provisions. For example, an enterprise constituted in the US or a branch located in the US and carrying on business in the US that invested in or sought to invest in Canada (including commitments of capital or other resources for economic activity) could bring a claim against Canada for breach of Chapter 11 before a neutral arbitral tribunal.

While some important investment obligations will be maintained as between all three countries (e.g. national treatment, Most Favoured Nation treatment, minimum standard of treatment, expropriation, and performance requirements), with the removal of ISDS as between Canada and the United States, individual investors from those countries will have limited enforcement mechanisms available to them. The investment obligations themselves are also qualified in new ways as compared to the protections that existed under Chapter 11. More information on the changes to the ISDS provisions can be found in a related [legal update](#).

Dairy and Agriculture

While generally maintaining its supply management system, Canada has made a number of concessions on dairy pursuant to the new agreement. Specifically, Canada agreed to increase US dairy imports in a number of product categories and to eliminate certain milk class prices.

With respect to the US dairy imports, under the USMCA, Canada has agreed to increased access for US dairy products in the form of tariff rate quotas (TRQs) for certain US-origin dairy products, to be implemented over six years. For example, the following products will eventually be allowed to enter Canada duty-free in the prescribed quantities:

- Milk: 50,000 metric tonnes (85% of which is for milk in bulk to be processed into dairy products used as ingredients for further processing);
- Cream: 10,500 metric tonnes (85% of which will be dedicated to cream for further processing);
- Skim milk powders: 7,500 metric tonnes;
- Butter and cream powder: 4,500 metric tonnes (50% of which shall ultimately be for further processing);
- Cheese for industrial use: 6,250 metric tonnes; and
- Cheese of all types: 6,250 metric tonnes.

Comparatively, under the Canada-European Union Comprehensive Economic and Trade Agreement (CETA), Canada established TRQs for cheese of 16,000 metric tonnes and for industrial cheese of 1,700 metric tonnes.

Pursuant to the USMCA, Canada will also implement increased TRQs for US-origin yogurt and buttermilk, whey powder, concentrated milk, milk powders, powdered buttermilk, products of natural milk constituents, ice cream and ice cream mixes, other dairy, chicken, turkey, egg and egg products, and broiler hatching eggs and chicks.

With respect to special milk classes, Canada committed to eliminating milk classes 6 and 7, and their associated milk class prices, six months after entry into force of the USMCA. Canada also agreed to ensure that the milk class prices of those products and ingredients "shall be established appropriately based on end use." The Canadian Dairy Commission introduced class 7 in February of last year. The class includes milk components, milk products and dairy ingredients for utilization in the production and processing of milk and dairy products, such as milk protein concentrate and skim-milk powder. Ontario had previously established a class 6 covering similar products. From its inception,

class 7 was a major negotiating point for the United States because US producers believed the low prices imposed pursuant to the class 7 designation adversely impacted US imports of these products into Canada.

Automobile Sector

Canada, the US, and Mexico were able to reach a compromise on rules of origin for the auto sector in the USMCA, following many months of US threats related to imports of automobiles. Specifically, the regional value content for vehicles under the new agreement will be increased from 62.5% under NAFTA to 75%. In order to be considered originating under the USMCA, passenger vehicles will ultimately require that 40% of content be made in plants with a production wage rate of at least USD 16 per hour, a provision likely meant to uphold the integrated North American auto sector while responding to concerns regarding the loss of jobs to Mexican plants with lower labour costs.

Additionally, pursuant to the US-Canada 232 Side Letter, Canada negotiated an exception for Canadian auto exports to any future US actions under section 232. Specifically, if the US imposes a measure pursuant to section 232 with respect to passenger vehicles, light trucks, or auto parts, the US has committed to exclude a specified quantity of Canadian auto products from such measures (2,600,000 passenger vehicles; light trucks; and a quantity of auto parts amounting to USD 32.4 billion annually).

Still Unresolved - Steel and Aluminium

In March 2018, President Trump imposed tariffs on steel and aluminum products under section 232 of the US TEA. The USMCA does not deal specifically with these tariffs. The question as to whether the US will lift these steel and aluminum tariffs vis-à-vis Canada and Mexico, effectively allowing Canada to remove its counter-measures, will need to be resolved in separate negotiations. On Monday, Minister Freeland indicated Canada hoped to take advantage of the momentum reached with the USMCA to reach an agreement with the US regarding the future of these tariffs.

The USMCA does establish a process for the establishment of future tariffs under section 232 of the US TEA. Under the US-Canada 232 Process Side Letter, Canada will have 60 days to negotiate with the US prior to any new measures under section 232 becoming applicable to Canada.

Other Features of the USMCA

Canada does not appear to have conceded to US demands for a “dollar to dollar” equivalent with respect to procurement liberalization under the agreement. The current text of the USMCA available online indicates that it applies only as between Mexico and the US. It is therefore unclear whether Canada will benefit from the procurement chapter of the USMCA. If it does not, then Canadian suppliers will need to rely on the procurement provisions of other trade agreements as they relate to government contracts in the US. Even if the USMCA procurement provisions are available to Canadian suppliers, it does not appear that the USMCA will extend to state, provincial or local entities in any significant way. This means that “Made in America” or other local content requirements imposed by state or local governments in relation to government projects will remain largely unaffected by the USMCA.

Other features of the revised agreement include:

- maintenance of an exemption for measures adopted or maintained by Canada with respect to its cultural industries;
- a new anticorruption chapter in which the parties affirm their resolve to prevent and combat bribery and corruption in international trade and investment;
- a labour chapter that obliges the parties to adopt and maintain certain internationally agreed rights, including freedom of association and the elimination of all forms of forced or compulsory labour, as well as statutes and regulations governing acceptable conditions of work with respect to minimum wages, hours of work, and occupational health and safety;

- new thresholds for the imposition of customs duties (\$150) and taxes (\$40) on Canadian consumers with respect to shipments of online purchases into Canada; and
- a new chapter on digital trade likely meant to modernize the 25-year-old agreement.

Conclusion

The success of the NAFTA renegotiations ultimately lies in what Canada was able to preserve in the face of often unprecedented US demands for concessions. While the USMCA includes important concessions by Canada, the trade agreement maintains many of the aspects of NAFTA that were critical to free trade in North America, including tariff-free access to the US market, protection of the Canadian auto sector, preservation of Canadian cultural industries, and the maintenance of the Chapter 19 dispute resolution process.

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