

# Steptoe

## USMCA Unlocked: Working Under the New NAFTA

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## **USMCA Unlocked: Working Under the New NAFTA**

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### **Introduction**

The Trump Administration is preparing to submit legislation to Congress to implement the US-Mexico-Canada Agreement (USMCA), designed to replace the North American Free Trade Agreement (NAFTA). President Trump has routinely referred to NAFTA as a “disaster,” identifying NAFTA renegotiation – or withdrawal – as a priority of his trade agenda based on the perception that trade and investment liberalization under NAFTA helped drive manufacturing jobs out of the United States. Furthermore, after over 25 years, NAFTA has begun to show signs of its age, no longer reflecting the state-of-the-art in foreign economic policy as it did in 1993, for example, through its provisions on services trade, intellectual property, investment protection, and state-owned enterprises (SOEs).

Notwithstanding the rhetoric surrounding NAFTA and the new negotiations, the USMCA does not reflect a fundamentally different approach to US trade agreements nor a wholesale revision of NAFTA. The disciplines governing tariff elimination, non-tariff barriers, and services liberalization remain largely the same and, with limited exception, any changes address post-Internet commercial topics and/or updated US approaches to trade issues as set out in 2015 Trade Promotion Authority legislation and modern free trade agreements (FTAs). Nevertheless, these changes and others carry potentially significant implications for business planning across sectors and provide insight into the Administration’s likely approach and priorities in subsequent trade negotiations.

The agreement must still go through ratification and implementation processes in all three countries before it can enter into force. Although the Administration is preparing implementing legislation to be submitted to Congress, a number of issues are likely to put off a final vote beyond this summer. In addition to the delayed economic impact report from the US International Trade Commission, the Trump Administration will need to address bipartisan concerns with Section 232 duties and Democratic objections to labor and intellectual property provisions and skepticism about enforcement. President Trump has threatened to withdraw from NAFTA to force a vote on the USMCA as it currently stands, although that appears increasingly unlikely. Whether the Administration negotiates an alternative to Section 232 duties with trading partners, re-opens the agreement, or works with members of Congress to modify draft implementing legislation, significant work remains to be done before Congress will be in a position to consider the agreement.

We discuss below in greater detail certain highlights of the USMCA in its current form, and offer the following initial takeaways:

### **Modernizing NAFTA**

The USMCA updates NAFTA and offers meaningful improvements for US commercial interests in a number of ways. For example, the USMCA dramatically strengthens existing rules on state-owned enterprises and enhances the labor and environmental obligations of the parties, including through labor obligations specific to Mexico. New disciplines have been introduced in digital trade and e-commerce, industries barely in existence at the time of NAFTA, and new obligations with respect to exchange rates have been introduced that make oversight of currency policies more effective. The Administration has even used the USMCA to address two of industry's strongest criticisms of the final Trans-Pacific Partnership (TPP) text, namely, the time period for data exclusivity for biologics and the exclusion of financial services from the scope of data localization restrictions, both topics that had little commercial relevance when NAFTA was signed.

### **Key Policy Departures**

While not having transformed the US approach to trade agreements, the USMCA still departs from longstanding US policy in certain areas. In particular, the USMCA eliminates rights and market access opportunities negotiated under NAFTA by severely restricting the availability of Investor-State dispute settlement (ISDS) and reducing access to Canadian and US procurement markets. This policy reversal reflects the Administration's views – unique to any administration in almost 40 years – that ISDS merely encourages offshoring and that the US procurement market should be largely reserved for US firms rather than negotiated away for access to foreign procurement markets.

### **No New Manufacturing Approach**

Given the criticism leveled by the President at previous trade agreements, and his belief that the USMCA would “transform North America back into a manufacturing powerhouse,” we might have expected the USMCA to comprise a fundamentally different systemic approach to manufacturing than previous FTAs. Instead, those innovative and commercially significant elements introduced by the Administration include revised rules of origin, primarily for autos, as well as the aforementioned limitations on ISDS and government procurement. Beyond the rules of origin and ISDS provisions, which alone are likely to have little impact on the manufacturing sector, most new disciplines in the USMCA bear considerable resemblance to those found in the TPP.

### **China on My Mind**

The USMCA makes clear that, even when negotiating a North American trade agreement, China remains front of mind for this Administration. Like the TPP, the USMCA contains new provisions on currency and state-owned enterprises, which – although the United States has previously had concerns with the operations of state-

owned enterprises in Canada and Mexico – appear more directly targeted at China’s state-led economic model. Beyond this set of disciplines, however, the USMCA goes further to deny any Chinese-owned or -controlled firm standing to launch an ISDS claim, and to expressly identify one party’s negotiation of an FTA with a “non-market country” as a possible basis for the other two parties to terminate the USMCA and replace it with a bilateral agreement.

### **Effective Enforcement?**

Contrary to the US push for a stronger dispute settlement mechanism during the Uruguay Round, and for more effective enforcement processes in recent FTAs, the USMCA does little to correct a flaw in NAFTA that allows a responding party to block the formation of a dispute settlement panel. Although dispute settlement under US FTAs has been limited, enforceability has long been viewed by Congress and stakeholders as critical to cementing the gains achieved through negotiation of strong substantive disciplines. The USMCA outcome appears to reflect the Trump Administration’s skepticism of the value of binding dispute settlement, perhaps driven largely by the US experience with certain disputes within the World Trade Organization (WTO) dispute settlement system.

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## I. Strengthening the North American Autos Sector

Ensuring that vehicles traded among the United States, Canada, and Mexico contain more regional and US-made value was a core Trump Administration objective in NAFTA renegotiations. Rules of origin are used in free trade agreements (FTAs) to determine whether a good originated from within the FTA area and can therefore qualify for the agreement's tariff benefits when the good moves among the member countries of the FTA. If a product imported by one FTA partner from another fails to qualify under the applicable rules of origin, that product typically receives the importing country's most favored nation (MFN) tariff rate. The MFN rate for a product imported into a particular country is the rate that would apply to that product if it had originated from another WTO Member with which the importing country does not have an FTA.

Building off of the existing high content requirement for autos and auto parts set out in NAFTA, the Administration succeeded in strengthening those rules of origin even more in order to further ensure that North American cars would be made primarily of North American components instead of components from Asia or Europe. Some of the changes to these rules of origin serve to advantage US products in particular. The Trump Administration's emphasis on strengthening the automotive rules of origin in a renegotiated NAFTA reflects its prioritization of US manufacturing as a metric of success in trade negotiations.

### A. Rules of Origin

Under NAFTA, autos and auto parts must satisfy, among other things, "regional value content" (RVC) requirements (i.e., a minimum percentage of value originating from the NAFTA parties) to qualify for NAFTA duty preferences. These include an RVC requirement of 62.5% for autos and light vehicles, and their engines and transmissions, and 60% for larger trucks, large truck engines and transmissions, and certain auto parts. With the exception of certain bearings and batteries, the USMCA significantly raises these content requirements across the board - to 70% and 75% for heavy trucks and passenger vehicles/light trucks, respectively, and to 70-85% (depending on the calculation method used) for auto parts. In achieving this outcome, the Trump Administration responded directly to concerns expressed by the steel industry, unions, and certain members of Congress about the thresholds in TPP's autos rules of origin.

At the urging of the Trump Administration, the USMCA also introduces two new requirements for imports of autos and auto parts that are unrelated to the regional value content of the imported automotive product as a whole. First, fresh off the heels of Section 232 import restrictions on steel and aluminum, the Administration secured additional benefits for those industries in the USMCA by requiring that

for any passenger vehicle, light truck or heavy truck to benefit from USMCA tariff preferences, at least 70% of the vehicle manufacturer's purchases of steel and aluminum over a prescribed time period (e.g., fiscal/calendar year, quarter or month of export) originate in the USMCA parties.

Second, the [USMCA](#) introduces "labor value content" (LVC) rules for the first time in any US trade agreement. These rules require that a significant portion of a car or truck's content (including R&D and assembly) be made by workers earning US\$16 or more per hour. For passenger vehicles, this LVC requirement will begin at 30% of an automobile's content and rise to 40% over three years. Light and heavy trucks will be subject to an LVC requirement of 45% on day one. Average auto industry wages in Mexico are currently [well below](#) this \$16 per hour threshold. This provision could therefore incentivize automakers to source certain inputs from companies operating in the United States and Canada, and it may eventually lead to rising auto industry wages in Mexico.

For the Big Three, given a head start with an already well integrated autos sector, including longstanding relationships with North American suppliers, these RVC and other changes appear to be [well within reach](#) if not already capable of being met based on existing supply chains. However, for European and Japanese automakers, with natural linkages to intra-firm and other suppliers in Europe and Asia, this may force reassessment of their reliance on those linkages, particularly if any of their manufacturing facilities in a USMCA nation are or were planning to serve as an export platform to other USMCA nations. [Initial evidence](#) indicates this may already be underway, as companies consider seeking new suppliers, or establishing or expanding manufacturing facilities, in [Mexico](#) and the [United States](#) simply to meet the USMCA requirements.

At the same time, retaining existing procurement strategies may be the economically desirable option for certain firms because American, Canadian, and Mexican MFN tariffs on many automotive products are quite low. For example, the [US MFN tariff](#) on passenger cars and many auto parts is just 2.5%. The costs of supply chain reconfiguration, not to mention the [significant compliance costs of performing complex LVC and RVC calculations](#), may discourage manufacturers from reconfiguring their supply chains for certain cars and components.

## **B. Exemptions for USMCA Parties from Potential Section 232 Autos Import Restrictions**

The Trump Administration's emphasis on automotive rules of origin, and the novel elements included in these rules, reflects its focus on actively using trade policy instruments to promote the US auto industry. In line with this focus, the US Department of Commerce (DOC) conducted an investigation under Section 232 of the Trade Expansion Act of 1962 into the national security impacts of automotive imports. The DOC has submitted a confidential report to the President containing the findings of its investigation and its recommendations for restrictions on automotive imports. While the DOC findings and recommendations have not yet been made

public, recent [reports](#) suggest that recommended options for import relief may involve tariffs of up to 25% on all vehicle and parts imports, [tariffs of up to 25% on a broad range of automotive products, with a focus on automotive parts](#), or targeted tariffs on certain automotive imports, such as “automated, connected, electric and shared (ACES)” vehicles and related technologies. The President now has until May 18, 2019 to decide whether he will implement the DOC recommendations for import restrictions, take alternative action, or opt not to take action. Aware of the possibility that the Trump Administration might soon impose tariffs on automotive imports, Canada and Mexico pressed for a commitment to exclude their products from any potential Section 232 autos remedy.

Although the USMCA offered no resolution to the existing Section 232 tariffs imposed on steel and aluminum from Canada and Mexico, it did produce an outcome with respect to the potential Section 232 action on autos. In [side letters](#) to the agreement, the United States committed to the exemptions in the table below “if [it were to] impose [such] a measure.”

	Canada	Mexico
Passenger Cars	2.6 million units annually exempted	2.6 million units annually exempted
Light trucks	All exempted	All exempted
Auto parts	\$32.4 billion in annual value exempted	\$108 billion in annual value exempted

These exemptions may indicate that the Trump Administration recognizes the particularly integrated nature of the North American automotive sector and the correspondingly significant impact that tariffs on Mexican and Canadian autos and parts would have on US vehicle manufacturers. As evidence of extensive regional integration, the [Congressional Research Service](#) has noted that “some motor vehicle parts and components cross the US border more than eight times in the production and assembly process” but that nevertheless, when compared with Canada and Mexico, “US motor vehicle manufacturing retains a large base of US component and assembly operations that has not been displaced by imports.”

Notably, these exemptions would comfortably cover the number of light autos and value of auto parts currently imported from Canada and Mexico. For 2017, [imports of passenger cars and light trucks together](#) amounted to 1.8 million units for Canada and 2.4 million units for Mexico, and [imports of auto parts](#) totaled \$16.4 billion from Canada and \$55.3 billion from Mexico. Indeed, at these levels, the exemptions provide room for trade diversion (i.e., increased imports from Canada and Mexico) in the event of Section 232 tariffs on other countries. These exemptions would therefore meaningfully reduce the overall impact of those tariffs on American auto manufacturers.

## II. Bringing NAFTA Into the 21st Century

### A. Digital Trade and E-Commerce

Twenty-five years after NAFTA was signed, in a world of growing reliance on the Internet, cloud computing, and artificial intelligence, cross-border data flows have taken on exponentially greater commercial significance and prompted governmental policy responses. In recognition of this fundamental change, Congress set out trade negotiating objectives on digital trade in the 2015 Trade Promotion Authority

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legislation, calling for duty-free trade in “electronic transmissions,” eliminating discrimination against electronically traded goods and services and cross-border data flows, and removing other restrictions on digital trade in goods and services, data flows, and data storage.

The USMCA meets these objectives with [rules](#) on digital products, data and cloud computing, and e-commerce, largely tracking the TPP digital provisions. With respect to digital products, the USMCA prohibits a party from requiring the disclosure of source code as a condition of

market access or discriminating against digital products of another party. It also prohibits customs duties on digital products transmitted electronically (effectively codifying the [WTO moratorium](#) that has been regularly renewed since 1998).

On data, the agreement prohibits a party from restricting cross-border business data transfers and from requiring data to be locally stored or processed as a condition of doing business in that party. This latter obligation is a notable advance from TPP in two respects. First, unlike in TPP, the financial services sector, with limited exceptions, is fully subject to the prohibition on data localization requirements in the USMCA. Second, whereas TPP explicitly authorized an exception to this data localization obligation for certain measures “to achieve a legitimate public policy objective,” the USMCA does not provide this specific exception. Although the general exceptions continue to apply (e.g., for public morals, health), the choice not to include an exception for “[any] legitimate public policy objective” removes a broad exception and reflects the view that there may more reasonably be a number of policy justifications requiring some limits on *data transfers* than for requiring the *use of local computing facilities*.

The USMCA facilitates e-commerce by encouraging the USMCA parties to accept electronic signatures as a valid form of authentication and raising and codifying the monetary thresholds below which customs duties on express shipments do not apply. Such *de minimis* levels benefit e-commerce platforms, their small business suppliers, and their shipping companies because higher thresholds mean customers in one party can purchase greater volumes of products from those platforms in another party without triggering any customs duties. By [setting these specific \*de minimis\* levels](#) – at \$117 (instead of \$50) for Mexico and C\$150 (instead of C\$20) for Canada – the USMCA goes beyond TPP’s requirement to simply establish monetary thresholds for customs duties.

At this time, the \$800 *de minimis* threshold set by US law will remain applicable for imports from Mexico and Canada. However, the USMCA includes a footnote authorizing a party to lower its *de minimis* level to provide “reciprocal” treatment for goods from another party that maintained a lower *de minimis* level. This possibility of the United States going “backwards” and significantly lowering its monetary threshold, even if to incentivize favorable action in another party, surprised many e-commerce businesses and other retailers as well as their supporters in Congress, prompting letters from a [group of industry associations](#), over 40 [members of Congress](#), and the [Senate Finance Committee](#) expressing their opposition to a lower US *de minimis* threshold.

Most notably, the USMCA includes for the first time in any US trade agreement a requirement for trading partners to essentially implement their own safe harbor for Internet service providers and online platforms. In other words, the USMCA requires Canada and Mexico to ensure, along the lines of Section 230 of the Communications Decency Act, that Internet service providers and online platforms are not treated as publishers of content and accordingly are immune from civil liability for material they display or transmit but do not create. This removal of the yoke of potential unlimited liability for third party content has led to Section 230 often being recognized as a fundamental pillar of the Internet economy. At the same time, however, the scope of immunity granted by Section 230, particularly as it has been broadly interpreted by courts, has been called into question recently, giving rise to a [growing debate about whether limits on that immunity need to be introduced or better clarified](#). Inserting a Section 230-like obligation into a trade agreement in the midst of such a debate will likely prompt concerns among those stakeholders pressing for limitations on the immunity granted by that provision.

## **B. Intellectual Property/Biologics**

One of the US objectives in recent trade negotiations has been to secure a period of [regulatory data protection \(RDP\) for biologics](#) that would protect the significant investment in clinical trials and other efforts to produce data needed for regulatory approval. In contrast to traditional “small molecule” drugs, biologics are complex medications derived from living organisms (e.g., proteins, genes, blood); biosimilars are medications that are [“highly similar”](#) to original patented biologics in form and function and, like generic drugs, are not different from the corresponding patented

products in any clinically meaningful way. Consistent with their obligations under the WTO Agreement on Trade-Related Intellectual Property Rights (TRIPS), many countries provide RDP for specified time periods for new drugs but in so doing make no distinction between new drugs in the form of biologics or in the form of small molecules. In light of the [relative novelty of modern biologics](#) and the [distinctive aspects of bringing biologics to market](#), including higher R&D costs and greater manufacturing sophistication, US law provides 12 years of data protection specifically for biologics.

Given the diverse markets involved and particular domestic political issues in certain countries, the United States could not secure a “clean” period of extended data exclusivity for biologics in TPP. Instead, [TPP](#) required that parties provide “effective market protection” for biologics, either in the form of a straightforward 8-year term of data protection or through a combination of at least 5 years’ data protection and “other measures” that would jointly achieve “a comparable outcome in the market.” This result also allowed for the possibility that in some circumstances, the time it would naturally take for a biosimilar to secure regulatory approval might be long enough such that, when combined with data protection, it would achieve for the original biologic the same effective market protection. The failure to achieve a more explicit commitment to a longer period of data protection for biologics immediately became a central criticism of the final TPP text from certain quarters in [industry](#) and [Congress](#).

The Trump Administration succeeded in extending the minimum period of data protection for biologics to 10 years, with no suggestion of alternative means of achieving that protection. Although this outcome still does not reflect the 12-year standard under US law, it takes a significant step towards addressing concerns with the TPP outcome. At the same time, a number of Democratic House members have already expressed [opposition](#) specifically to the biologics outcome, with a [letter expected from over 100 Democratic lawmakers](#) calling on the Administration to renegotiate those provisions with a view to lowering prescription drug prices. This increasingly vocal opposition will contribute to the complexity of securing the votes needed for passage of USMCA implementing legislation.

## **C. Labor**

The USMCA labor provisions represent a significant advance over NAFTA’s labor side agreement, largely tracking the TPP labor commitments but introducing notable new disciplines as well.

### **1. NAFTA**

NAFTA was the first trade agreement in the world to formally address workers’ rights. The parties accomplished this through a [labor side agreement known as the North American Agreement on Labor Cooperation, or NAALC](#). As the first of its kind, the NAALC approach centered on a party’s enforcement of its own labor laws, leaving the content of those laws largely to the party’s discretion, apart from

a broad commitment to “ensure that its labor laws and regulations provide for high labor standards, consistent with high quality and productivity workplaces, and [to] continue to strive to improve those standards in that light.” As such, each party’s fundamental obligation was to “effectively enforce [those laws] through appropriate government action.”

Although the NAALC did not prescribe particular labor standards, it did identify labor principles that the parties “[were] committed to promote,” including in respect of the freedom of association, the right to strike, migrant workers, equal pay for equal work, occupational safety, child labor, and forced labor. The side agreement also introduced novel obligations for parties to establish independent and transparent legal institutions to adjudicate alleged violations of domestic labor laws and to put in place procedures to promote public awareness of domestic labor policymaking.

The NAALC introduced a public submissions process designed to help hold countries accountable for their labor law violations and labor conditions. Specifically, the NAALC allowed stakeholders to [submit comments](#) related to any labor law matter occurring in another NAFTA country to their own country’s [designated NAALC office within the labor ministry](#). A submission to such designated office could lead to consultations with the designated office in the relevant NAFTA party and a report issued by the home country designated office, but these actions were taken solely at the discretion of the home country designated office. Based on the review conducted by that designated office, the issue may be elevated to further consultations at the ministerial level. Failure to resolve the issue in those consultations could lead to review by an expert committee and, for certain labor law matters, formal dispute settlement proceedings initiated by a party.

NAFTA was the first international agreement to subject labor obligations to binding state-to-state dispute settlement. However, these procedures were separate from those available for obligations in the main text of the agreement, and they applied only to disputes that (1) related to “persistent” violations by a party (2) of its own “occupational safety and health, child labor or minimum wage technical standards” (3) in situations where the pattern of enforcement failures were “trade-related [and] covered by mutually recognized labor laws.” A finding of violation could lead to development of an action plan for the offending party to remedy its failure, followed by a monetary fine if that failed, and ultimately the possibility of trade sanctions. These sanctions were limited to 0.007% of trade in goods between the parties, and the complaining party had to limit punitive tariffs to the lesser of the pre-NAFTA levels or the MFN rate. No labor dispute under the NAALC has actually proceeded to arbitration, and therefore fines and trade sanctions have never been imposed under the NAALC.

## **2. TPA/TPP**

Over 20 years after NAFTA was signed, with its side agreements on labor and environment, the political and policy landscape had shifted significantly with respect to the salience of labor and environmental issues in the trade context.

Congress made clear, in the latest iteration of Trade Promotion Authority in 2015, its expectation for a much more robust and enforceable set of labor and environment disciplines in any regional trade agreement. As to labor, Congress identified the following among its priority objectives: the implementation of specific International Labor Organization (ILO) core labor standards; commitments not to derogate from, or fail to effectively enforce, domestic labor laws; and coverage of labor commitments under the same dispute settlement process as other commitments.

Consistent with these objectives, TPP followed an entirely different approach from the NAALC, greatly expanding the scope of the labor chapter to include prescriptions on specific laws that parties would need to adopt and maintain. The agreement required parties to implement [ILO core labor standards](#) on freedom of association, the right to collective bargaining, compulsory labor, child labor, and non-discrimination. TPP also required that parties establish laws relating to minimum wages, hours of work, and occupational safety and health, although it did not further define what those wages, hours or conditions should be. TPP also adopted a more fulsome public submissions process and greater opportunities for public participation in the implementation of labor commitments. All of these obligations were subject to the agreement's standard dispute settlement process. Finally, although not a separate and enforceable set of commitments under TPP, [Mexico did institute a series of constitutional reforms relating to labor courts, collective bargaining and union representation](#), seeking to respond to concerns raised in Congress and by US labor leaders.

### **3. USMCA**

The [USMCA](#) largely replicates the TPP's provisions on ILO standards, wages and hours, health and safety, public submissions and participation, and applicability of dispute settlement. It also goes further to build on the strong TPP labor outcomes in meaningful ways. First, it makes the passage of new Mexican labor rights laws, including significant legislation implementing the aforementioned constitutional amendments, subject to dispute settlement. With this legislation, [assuming it meets the requirements of the USMCA](#), Mexico will have taken tangible steps to address some of the strongest criticisms on labor, including notably the prevalence of ["protection contracts"](#) in Mexico, or artificial unions set up by companies without the input of workers. These sham unions keep Mexican wages artificially low, and therefore, from the US perspective, contribute to the offshoring of US jobs to Mexico.

Second, the USMCA commits parties to uphold a number of new progressive workers' rights. It introduces an obligation that did not exist in the TPP that requires parties to address "violence or threats of violence against workers" that are trying to exercise their fundamental ILO rights. Parties must also provide "job-protected" leave for "birth or adoption of a child and care of family members." Finally, [as originally negotiated](#), each USMCA party would have been required to "implement policies that protect workers against employment discrimination on the basis of sex, including with regard to pregnancy, sexual harassment, sexual orientation, gender identity, and caregiving responsibilities."

This language created controversy in the United States by highlighting the contentious issue of whether existing federal law, in particular Title VII of the Civil Rights Act of 1964, prohibits discrimination on the basis of gender identity or sexual orientation. The Trump Administration’s position, and that of many congressional Republicans, is that it does not, a position generally rejected by Democrats. US federal appeals courts are split, and the Supreme Court has not yet resolved this matter.

In response to Republican concerns, the Trump Administration renegotiated this provision to limit the obligation to “implement policies *that [a party] considers appropriate* to protect workers.” Following a belt-and-suspenders approach, the Administration supplemented this self-judging standard with a footnote asserting that the provision “requires no additional action on the part of the United States, including any amendments to [Title VII], in order for the United States to be in compliance.”

Finally, it is important to note that although the USMCA brings labor obligations under the rubric of the same dispute settlement mechanism applicable to all of the commercially-oriented obligations, that mechanism, like in NAFTA, effectively allows a responding party to block the formation of a dispute settlement panel (see Section VI on “Enforcement”). Given the particular significance attached by Democrats to enforcement of labor obligations (see Section VII on “Implementation”), and the Administration’s own [emphasis on the “full\[\] enforce\[ability\]” of labor obligations](#), this limitation tempers the success of the substantive labor improvements achieved in this negotiation.

## **D. Environment**

Like the USMCA labor chapter, the USMCA environment chapter is more robust than its NAFTA predecessor. Much of the USMCA environmental chapter is grounded in Trade Promotion Authority objectives and/or taken from the TPP, but in certain respects, the USMCA does break new ground on environmental issues.

### **1. NAFTA**

The environmental provisions added to NAFTA were set out in a separate side agreement, the [North American Agreement on Environmental Cooperation \(NAAEC\)](#). Like the NAALC, the NAAEC, as the first effort to bring environmental disciplines into a regional trade agreement, did not seek to directly establish new environmental standards to be implemented by the parties. Instead, it targeted national enforcement of national environmental laws and strengthening institutions to facilitate environmental policymaking and enforcement. The principal obligation under the NAAEC, therefore, was for each party to “effectively enforce its environmental laws and regulations through appropriate governmental action.”

Notwithstanding its focus on enforcement, the NAAEC committed parties to “maintain high levels of environmental protection and [to] strive to continue to

improve” those laws and policies. As with the NAALC, the NAAEC also committed parties to establish independent and transparent legal institutions to adjudicate alleged violations of their domestic environmental laws and to educate the public on environmental laws and the state of the environment.

In furtherance of the obligation to effectively enforce domestic environmental laws, the NAAEC established a groundbreaking public submissions process that has sought to serve as an additional vehicle of oversight of a party’s environmental conditions and enforcement. Although similar to that set out in the NAALC, the NAAEC provided more explicitly for a report to result from the review of a given submission. Specifically, the Secretariat of the [Commission for Environmental Cooperation \(CEC\)](#) would receive submissions alleging a party’s failure to effectively enforce its environmental law and, upon instruction of the CEC Council (i.e., an affirmative vote by two of the three parties), develop a factual record and [publish these submissions and factual records](#) for public review.

The NAAEC set up a stand-alone process for state-to-state disputes under this side agreement. As in the case of labor, a complaining party may challenge only another party’s “persistent pattern of failure” to enforce its environmental law and must demonstrate that such failure is related to trade between the parties, but there is no limitation on the scope of environmental law that may be the subject of the dispute. In other respects, such as the constraints on the monetary sanctions and the punitive tariffs that may be imposed, the NAAEC follows the same approach as the NAALC.

## **2. TPA/TPP**

Like in the context of labor, Trade Promotion Authority legislation enacted in 2015 significantly expanded objectives for environmental provisions. Congress included in those objectives the implementation of specific multilateral environmental agreements (including the Montreal Protocol on Substances that Deplete the Ozone Layer (Montreal Protocol) and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)); commitments not to derogate from, or fail to effectively enforce, domestic environmental laws; and coverage of environmental commitments under the same dispute settlement process as other commitments.

TPP addressed these objectives and developed a number of additional obligations requiring action in respect of a series of specific environmental challenges. Beyond the obligations to implement specific multilateral environmental agreements, TPP committed parties to “maintain or strengthen government capacity and institutional frameworks to promote sustainable forest management” and promote legal trade in forest products. For the first time in any trade agreement, TPP also prohibited subsidies for fishing vessels linked to illegal, unreported, and unregulated (IUU) fishing as well as fishing subsidies that contribute to overfishing. In addition, TPP committed parties to adopt provisions similar to the US Lacey Act, by requiring parties to prevent trade or transshipment in flora and fauna that had been taken or traded in violation of that party’s conservation laws. Again, as with labor, each of these commitments would have been subject to the same dispute settlement processes as other obligations in the agreement.

### 3. USMCA

In addition to provisions meeting the objectives set out in Trade Promotion Authority legislation, the USMCA retains TPP provisions supporting effective enforcement of environmental laws and maintains TPP's commitments in relation to illegal logging, forest and fisheries management, and fisheries subsidies.

The USMCA also goes beyond TPP in certain ways. For example, the USMCA includes vessel operators in the scope of the prohibition on fisheries subsidies and commits all parties to work towards addressing those subsidies in the WTO, which is particularly significant given that WTO Members have been working for 18 years on an agreement on fishing subsidies and illegal fishing and [aim to complete such an agreement this year](#).

The agreement also includes commitments to adopt restrictions on whaling, consistent with existing international conventions and in a manner recognizing the special importance of whaling in indigenous communities. Finally, the USMCA introduces a requirement to conduct environmental impact assessments for central government projects that may have an effect on the environment.

Through a side agreement referred to as the [Environmental Cooperation Agreement \(ECA\)](#), the USMCA maintains the CEC organizational structure and contemplates certain "strategic priorities" for trilateral environmental cooperation (largely tied to the actual USMCA provisions) that the CEC could set. The USMCA slightly enhances the CEC Secretariat public submission process by making publication of submissions and related information the default instead of just an option for the Secretariat.

Notably absent from the USMCA, either in terms of commitments or identified areas of cooperation, is any mention of climate change. The final TPP text also failed to reference climate change explicitly and instead contained a limited provision calling for cooperation in a number of areas supporting the "transition to a low emissions economy," including renewable energy, low emissions technologies, and sustainable transport and infrastructure. The ECA similarly identifies certain areas of potential cooperation relating to "low emissions." However, unlike TPP, the ECA lists these subjects only as *possible* areas of cooperation and does not situate this possible cooperative activity in the context of a commitment to *transitioning* to a low emissions economy. Furthermore, rather than TPP's "clean and *renewable* energy resources," the ECA lists "all clean, efficient energy sources *that enhance energy security*" as an area of cooperation.

In the USMCA, parties are to bring environmental disputes to the same dispute settlement system applicable to all USMCA commitments. In the event that the parties cannot resolve the dispute after a panel ruling, complaining parties can impose proportional trade measures against the violating party in the same manner authorized for labor (and other) chapter violations. Again, as with labor, the prospect of a party blocking state-to-state dispute settlement undermines the enforceability of these obligations.

## E. Standards and Regulations

The USMCA builds on the TPP's provisions related to technical barriers to trade (TBT) and the development of regulations more broadly. While these rule changes are process oriented, they improve the ability of American stakeholders to shape rules and regulations. Drawing from and expanding upon the relevant TPP provisions, the USMCA's regulatory disciplines constitute a significant advance from those found in NAFTA and the WTO Agreement on Technical Barriers to Trade (TBT Agreement). To be sure, the USMCA, like the TPP, reaffirms core provisions of the WTO TBT Agreement, such as non-discrimination rules regarding standards, regulations and procedures establishing compliance with those standards/regulations (i.e., conformity assessment procedures), as well as provisions aimed at promoting transparency in the rulemaking process. However, the USMCA also includes novel provisions that serve to promote data-based policymaking, require government rationales for particular regulatory approaches, improve transparency, and facilitate public participation in rulemaking processes.

First, the USMCA requires parties to use the criteria set out in the WTO TBT Committee Decision on International Standards as the sole basis for determining whether a standard constitutes an "international standard." The requirement to use these criteria is critical because under the WTO TBT Agreement, as well as TPP and the USMCA, a party is generally required to base its regulation on a relevant international standard and provide an explanation if it chooses not to do so. The USMCA goes further to provide that, where multiple, relevant international standards exist, a party must consider using each of them as the basis for regulation; and, where no international standard exists, a party must consider a standard developed in another USMCA party as the basis for regulation. In both instances, the party developing the regulation must explain why it rejected a particular international standard or standard developed in another USMCA party.

Second, the USMCA, like TPP, goes beyond the WTO TBT Agreement to require, rather than "encourage," a party to provide national treatment and MFN treatment to those entities located in another party that evaluate a product's compliance with standards and regulations (i.e., conformity assessment bodies). As a result, a conformity assessment body located in another party may be eligible to conduct any test or provide necessary certifications of conformity with a regulation, as required by the party implementing that regulation, and may do so under the same conditions and fees applicable to domestic conformity assessment bodies. Where a party does not accredit or recognize a conformity assessment body, or does not accept test results or certifications from such a body, it must explain the reasons for its decision upon request of another USMCA party.

Third, the USMCA reinforces and further specifies the obligations in the WTO TBT Agreement to publish proposed and final regulations. For example, the agreement clarifies that the "reasonable time" provided for public comments on proposed regulations should "normally" be 60 days, and the "reasonable interval" between publication of a final regulation and its entry into force should generally be at least

six months. As with TPP, the USMCA explicitly requires a party to treat firms from another party no less favorably than its own firms when it comes to opportunities to submit comments on proposed regulations and to the government's consideration of those comments. The agreement also requires a party to explain, when it issues a final regulation, how it addressed substantive issues raised in public comments.

Fourth, TPP introduced a series of sectoral annexes to its TBT chapter containing a number of disciplines largely borne out of industry experience in various global markets. The sectors covered by TPP were cosmetics, medical devices, pharmaceuticals, information and communications technology (ICT), wine and spirits, proprietary formulas for prepackaged foods and additives, and organic agricultural products. The USMCA followed a similar approach but limited its coverage to cosmetics, medical devices, pharmaceuticals, ICT, chemical substances, and energy performance standards. These sector-specific provisions covered a range of disciplines including prohibitions on requiring the transfer of cryptographic keys or algorithms (ICT), restrictions on company data required for marketing approval for medical devices and drugs, and requirements to apply risk-based approaches to evaluating the safety of cosmetics and medical devices. Notably absent from these USMCA sector-specific provisions is the wine and spirits sector, a significant traded sector among USMCA parties.

Finally, the USMCA chapter on Good Regulatory Practices expands on provisions set out in the TPP Regulatory Coherence chapter to provide significant guidance on the approach to developing regulations more generally. The USMCA requires each party to explain and provide data underlying a proposed regulation, use sound statistical methodologies when drawing conclusions from surveys, identify what other regulatory approaches it considered (including no regulation at all), and provide reasons for its selected regulatory approach. It also requires a party to consider cost-benefit analyses when preparing a regulatory impact assessment and to periodically review regulations to determine whether they should be "modified, streamlined, expanded or repealed."

## III. Keeping an Eye to China

The Trump Administration pursued certain objectives in the USMCA that appear to be driven more by a focus on disciplining or countering China's behavior than addressing specific concerns with Canada or Mexico. State-owned enterprises (SOEs) in Canada and Mexico largely do not compete with private firms or are limited to one or two sectors, and neither country's policies have raised US concerns of currency manipulation. Nevertheless, negotiating meaningful disciplines on these subjects advances the US interest in promoting rules that push China, in particular, to avoid distorting its internal market or global markets through SOEs and foreign exchange intervention. Similarly, discouraging US trading partners from entering into preferential trading agreements with state-led economies such as China can help mitigate the potential for US goods and services facing further unfair competition in those foreign markets.

### A. State-Owned Enterprises (SOEs)

The USMCA includes the most expansive rules concerning the activities of SOEs in any US free trade agreement (FTA) to date. While the USMCA SOE chapter uses the relatively robust TPP chapter as a starting point, it also strengthens the TPP SOE provisions in meaningful ways and is a strong first step towards a broader approach to countering state-led commercial activity in the global marketplace.

#### 1. Previous US Trade Agreements

Beginning as early as the negotiations leading to the General Agreement on Tariffs and Trade (GATT) in 1947, the United States has long recognized the need for disciplines to ensure that SOEs and firms to which the State grants exclusive privileges (such as regulatory powers) do not distort cross-border trade and investment flows. The United States has included disciplines on those firms – that is, firms that the state owned, or controlled through ownership interests, or which the state designated to hold certain privileges in the market – in [NAFTA](#) and most of its free trade agreements since. Those agreements generally required such firms to provide non-discriminatory treatment, and to act in accordance with commercial considerations (i.e., make decisions like a private entity), in the sale or purchase of goods and services. Where such firms were endowed with regulatory or other governmental authority, those agreements treated them as governmental actors and required them to comply with the state's obligations under the respective agreement.

The modest disciplines in existing US trade agreements reflect a focus on actions by SOEs themselves that could discriminate against imported products or foreign-

invested firms, for example, through their purchasing decisions or selection of customers. However, today's concerns with SOEs, driven largely by China's state intervention, are more far-reaching. More challenging than the behavior of these individual firms are the actions and policies of the government that can fundamentally alter the competitive landscape in favor of SOEs and other chosen firms and, because of China's sheer size, potentially alter that landscape on a global level.

## 2. USMCA

As a solid initial step to counter this challenge, following the approach negotiated in TPP, the [USMCA significantly expands NAFTA's SOE disciplines](#) to address governmental actions that favor SOEs and thereby distort competition vis-à-vis goods, services, and covered investments of other USMCA parties. The USMCA does this by building on the framework of the WTO Agreement on Subsidies and Countervailing Measures ("SCM Agreement"), including drawing on well-established concepts like "adverse effects," "material injury," and "domestic industry."

Specifically, the agreement prohibits a party from providing an SOE with non-commercial assistance – whether in the form of grants, financing, or equity infusions – that causes "adverse effects" to another party. This prohibition covers assistance provided directly from the government, from another SOE, or indirectly through government direction of a non-SOE. Adverse effects include where the non-commercial assistance to an SOE has impeded sales of the competing USMCA good or service in the SOE's market or in the market of another USMCA party.

In addition, the USMCA expressly recognizes the potential harm from non-commercial assistance provided by a party to any of its SOEs that operates as a covered investment *in the territory of another party*. Given the unique potential for such assistance to effectively distort competition in that other party's market, the USMCA prohibits a party from causing "material injury" to the domestic industry of another party through such assistance. As with the evaluation of injury as an "adverse effect" under the SCM Agreement, this injury analysis largely tracks the approach used in countervailing duty investigations.

The USMCA also reflects a meaningful improvement from TPP's SOE provisions in three respects. First, the agreement defines SOEs more broadly than TPP to include not only firms with a greater than 50% government ownership interest, but also firms where the government may hold a minority interest but nevertheless retain "power to control the enterprise." Given [the explicit desire of China's Communist Party to play a more meaningful role in management of even private firms](#), this is a useful expansion of the SOE definition. Second, the agreement goes further than TPP in establishing certain forms of non-commercial assistance to SOEs as being prohibited outright. This prohibited assistance includes situations where the SOEs were otherwise unable to obtain market financing or were insolvent with no credible restructuring plan, as has been the case with [China's "zombie" firms](#). Third, the USMCA appears to adopt a more flexible "specificity" requirement that applies to the assistance covered by

its disciplines than TPP. Whereas TPP generally covered only such assistance where the beneficiaries were primarily SOEs, the USMCA only requires that the assistance have been limited to a “certain set of enterprises” as opposed, for example, to being generally available. The USMCA thus captures non-commercial assistance to SOEs even where SOEs form only one part of the particular industry receiving the assistance.

## **B. Currency Manipulation**

The USMCA builds on TPP’s currency provisions to ensure transparency in governments’ interventions in foreign exchange markets and establish a consultation process should any government perceive such action as a competitive devaluation.

Because a government can use significant purchases of foreign currency to lower its exchange rate, thereby making its products cheaper overseas and artificially boosting its exports, exchange rate issues have long been tied to trade concerns and US trade policy. In the early 1980s, the focus was West German and Japanese intervention in foreign exchange markets followed by US-led concerted action to counter such intervention in the form of the [Plaza Accord](#). Chinese currency practices drew attention in the early 1990s, with [Treasury identifying China as a “currency manipulator,”](#) but China continued intervening in foreign exchange markets through the first decade of the 2000s to suppress the value of the yuan just as it significantly ramped up its export-led growth. Today, China still has no floating exchange rate, relying instead on the sale and purchase of foreign exchange by the People’s Bank of China to keep the yuan within a certain band of value. Although Treasury did not designate China as a currency manipulator in its semi-annual currency [report](#) last fall, that report made clear [its unwavering focus on China going forward](#), regardless of whether China meets the technical criteria to be labeled a manipulator. Indeed, the Trump Administration has [stated](#) that currency remains a critical part of ongoing US-China trade negotiations and will be reflected in any outcome.

In light of growing unchecked “beggar-thy-neighbor” intervention in foreign exchange markets, most prominently by China but also by [Japan and possibly other TPP parties](#), Trade Promotion Authority legislation in 2015 called for “cooperative mechanisms, enforceable rules, reporting, monitoring, transparency, or other means” to ensure that trading partners “avoid manipulating exchange rates in order to prevent effective balance of payments adjustment or to gain an unfair competitive advantage over other parties to the agreement.” The Obama Administration accordingly negotiated a side declaration to TPP aimed at combatting trade-distorting currency practices, in particular, government intervention in foreign exchange markets to devalue its currency to make its exports more competitive and imports less competitive.

Whereas NAFTA did not address exchange rates, and notwithstanding the fact that neither Canada nor Mexico have ever appeared on the “monitoring list” of Treasury’s semi-annual currency report, the USMCA incorporates many of those TPP provisions into a [currency-focused chapter](#) included in the main text of the

agreement. It includes shared expressions of support for market-determined exchange rates and a recognition of respective commitments under the Articles of Agreement of the International Monetary Fund (IMF) not to seek unfair competitive advantage by manipulating exchange rates. The agreement also requires parties to regularly publish macroeconomic data and monetary policy information, including interventions in spot and forward foreign exchange markets, which can help ensure meaningful oversight and compliance with those IMF commitments.

The USMCA also goes beyond TPP in certain respects. It states that a party “should” promptly inform another party when carrying out a “foreign exchange market intervention... with respect to the currency of that other [p]arty.” Furthermore, in addition to regular meetings of finance officials from all parties, the agreement provides for “expedited bilateral consultations” between finance officials when requested by a party on any issue relating to exchange rate practices and transparency obligations, including actions that the requesting party “considers associated with competitive devaluation.” The transparency and reporting obligations are further subject to the standard dispute settlement processes under the agreement, including possible trade sanctions, but only where the failure to meet those obligations has been “in a recurring or persistent manner.”

Finally, it is worth noting that the USMCA includes new language – not in the TPP declaration – clarifying the “scope” of this chapter, providing that it “does not apply with respect to the regulatory or supervisory activities or monetary and related credit policy and related conduct of an exchange rate or fiscal or monetary authority of a [p]arty.” Although this scope language was not included in TPP, it does not appear to reflect a change in view about the applicability of these currency provisions, at least with respect to the United States. Indeed, the explicit exclusion of monetary policy is consistent with the view of the United States that the currency-related behavior that lies at the heart of trade concerns stems not from [monetary policy, which is focused on price stability and full employment in the domestic economy, but from government interventions in foreign exchange markets that are designed to devalue that government’s currency and affect export competitiveness.](#)

### **C. Non-Market Country Provision**

The Trump Administration succeeded in securing an [unprecedented provision](#) in the USMCA that “allow[s]” the other parties to terminate the agreement and enter into their own bilateral agreement if another party “[enters] into a free trade agreement with a non-market country.” A “non-market country” is defined as one that “on the date of signature of [the USMCA] a Party has determined to be a non-market economy for purposes of its trade remedy laws; and with which no Party has signed a free trade agreement.” China and Vietnam are the two largest countries so designated by the United States, but only China would be subject to this provision because Canada and Mexico have already signed the [Comprehensive and Progressive Trans-Pacific Partnership \(CPTPP\)](#) with Vietnam.

Because any party to the USMCA can terminate the agreement on six-month notice for any reason (this right existed within NAFTA as well), this provision does not provide the parties with any specific new authority. Still, by building into the newly-negotiated USMCA an explicit threat to terminate the agreement, it serves as an unquestionable effort by the United States to discourage its trading partners from entering into a free trade agreement with China.

This possibility was most likely to arise in the context of Canada, which had held exploratory talks with China but after [failing to announce the launch of FTA negotiations in 2017](#), was [focusing instead on sectoral discussions with China](#). Recent [developments regarding Huawei](#) have put such talks on hold. Should talks resume, however, WTO rules would allow Canada and China to take only limited steps to enhance bilateral trade on a *sectoral basis* without a comprehensive agreement that would trigger this USMCA provision.

The Trump Administration has already stated its intention to push for a similar non-market country provision in future trade negotiations, beginning with [Japan](#), the [EU and the UK](#). If negotiations on the [Regional Comprehensive Economic Partnership \(RCEP\)](#) involving Japan and China do not conclude in time, Japan may confront a similar choice.

In any event, merely including this provision – which, as noted, provides no new legal authority – has already raised the pressure future administrations will be under when faced with the decision whether to withdraw from a trade agreement because of a trading partner’s decision to enter into its own, separate agreement with China.

## IV. Breaking From Tradition

### A. Investor-State Dispute Settlement (ISDS)

In a marked departure from trade agreements negotiated under Republican and Democratic administrations for more than two decades, and from over 35 years of investment treaty negotiations, the USMCA phases out investor-state dispute resolution entirely for Canada and greatly curtails this option in respect of Mexico. Going forward, it will only be available in most sectors for a subset of the investment protections provided by the agreement, and even then, only after the investor has first exhausted domestic remedies in Mexico or the United States.

NAFTA's investor-state dispute settlement (ISDS) mechanism was a first of its kind: the first such mechanism to be included in a trade agreement as opposed to a bilateral investment agreement (BIT); the first such mechanism covering Mexico, historically a staunch opponent of foreign investors seeking remedies in international arbitration in lieu of domestic courts; and the first such mechanism agreed to between developed countries (Canada and the United States) instead of the typical developed- (capital-exporting) and developing- (capital-importing) country agreement. The full complement of NAFTA investment protections and access to ISDS to enforce those protections was generally available to a wide range of investors and their investments.

Nearly all US trade agreements and BITs since then, including the modified ISDS provisions found in TPP, have built on the NAFTA approach. The USMCA fundamentally upends this well-established US approach to foreign economic policy by significantly narrowing the availability of ISDS for US investors with investments in Canada and Mexico.

With respect to Canada, the USMCA terminates the ISDS mechanism altogether after a brief transition period. However, US or Mexican investors who made investments covered by NAFTA will have three years from the date NAFTA is terminated to submit new claims against Canada under the NAFTA ISDS procedures. Those arbitrations, as well as those that have already been commenced under NAFTA, will proceed to their final disposition. No other ISDS claims may be filed against Canada or the United States by investors from the other party, leaving them at that point to rely exclusively on domestic judicial recourse. Mexican and Canadian investors will continue to be able to seek remedies from the other party for investment violations but will now need to rely on the ISDS mechanism established by the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).

With respect to US-Mexico investment disputes, the USMCA retains the ISDS mechanism but greatly limits its applicability in three ways. First, as a general matter, certain substantive investment protections will no longer be enforceable through ISDS. Claims of indirect expropriation and a breach of the “minimum standard of treatment,” common grounds for ISDS claims submitted under NAFTA, are no longer subject to ISDS. Obligations relating to performance requirements and transfers are similarly excluded. Claims may still be made on the basis of direct expropriation, as well as national treatment and MFN commitments, but even those non-discrimination claims no longer cover “pre-establishment,” that is, conditions governing the entry and establishment of foreign investment in the host country market. Therefore, an investor is limited to claims alleging discrimination with regard to the “expansion, management, conduct, operation, and sale or other disposition of investments.”

Second, the USMCA does retain the traditional broad scope for ISDS in disputes involving government contracts in certain sectors that are heavily regulated by the government of Mexico (Oil and Gas, Energy, Telecommunications, Transportation and Infrastructure). Only with respect to government contracts in these five sectors can an investor seek ISDS recourse for infringement of *any* of the substantive investment protections provided for in the USMCA. The agreement introduces an additional, unique qualification to this right, namely, requiring that the respondent country be party to another agreement that provides for ISDS. As such, if either the United States or Mexico decides to withdraw from all other ISDS agreements, ISDS would automatically no longer be available under the USMCA in the specified sectors in respect of that party. In that circumstance, ISDS would appear to remain available for all other sectors in the limited manner described in the preceding paragraph.

Finally, the USMCA introduces a requirement to exhaust domestic remedies, precluding any ISDS claim until the investor has first challenged the particular governmental action in a domestic court or agency, and either the investor has received a decision from a court of last resort or 30 months have passed. These 30 months count against the four-year time period within which an ISDS claim can be initiated and can significantly delay the resolution of an investor’s claims. Introducing this requirement goes some way to responding to [concerns about US measures being challenged by foreign investors in unaccountable tribunals](#), which is ironic given that such arguments were at the [core of the Calvo Doctrine pressed by Mexico and other Latin American countries for decades and that avoiding potentially arbitrary or discriminatory local processes was one of the principal motivations behind ISDS](#).

The Trump Administration’s push to depart from longstanding US policy to significantly limit ISDS stands in stark contrast to its decision to leave largely untouched the NAFTA Chapter 19 binational panel review process, which is the only other mechanism for private parties to challenge the actions of a NAFTA government. The [USMCA retains this mechanism](#) for any party to challenge another’s imposition of antidumping and countervailing (AD/CVD) duties before a binational panel to “replace [domestic] judicial review” in the importing party. Retaining this mechanism was a [major objective of Canada](#), whereas the United

States initially [pushed to remove it](#) from any renegotiated agreement. As such, agreeing to keep AD/CVD review in USMCA constitutes a particularly significant US concession. Reportedly, the Administration agreed to maintain this mechanism in exchange for Canada agreeing to provide [increased market access](#) for US [dairy, poultry, and egg exports](#), which was a key Administration objective vis-à-vis Canada.

## **B. Government Procurement**

The USMCA also departs significantly from the longstanding US negotiating approach to government procurement in previous trade agreements, again by excluding Canada entirely. Since the Tokyo Round, the United States has consistently supported negotiations on government procurement disciplines and market access at the multilateral level in the GATT/WTO and in most of its FTAs including NAFTA. Upon signing the TPP, the United States, Canada, and Mexico [agreed separately for the TPP government procurement chapter, including its market access commitments, to replace the government procurement provisions of NAFTA, effective on the date of TPP's entry into force in all three countries](#).

Now, however, the USMCA does not incorporate the TPP outcome into NAFTA. Instead, [it excludes Canada from the government procurement chapter entirely](#). Canada's relationship with the United States will be governed by the WTO Agreement on Government Procurement (GPA), and Canada's relationship with Mexico will be governed by the Comprehensive and Progressive Agreement on Trans-Pacific Partnership (CPTPP). The exclusion of Canada from the USMCA has more limited impact in practice because of the level of market access that Canada provides under the revised GPA.

That said, relying on the revised GPA rather than the TPP (as planned to be imported into NAFTA) could still result in meaningful changes to US firms' access to Canadian procurement with regard to coverage of services and covered entities. Canada's thresholds (the values at which procurement is opened to foreign suppliers) are identical under the TPP and the revised GPA in respect of all covered entities: 130,000 special drawing rights (SDRs, the unit of account for the IMF, based on a weighted average of a basket of global currencies) for central government entities; 355,000 SDRs for sub-central and "other entities" (i.e., government enterprises); and 5 million SDRs for construction services for any covered entity. However, Canada's list of covered entities is broader under TPP, [which includes 95 central government entities and 22 government enterprises](#) instead of 78 and 10, respectively, under the revised GPA. Furthermore, TPP covers far more service sectors than the revised GPA, including telecommunications, technical testing, and business network services for central government entities.

With respect to the United States and Mexico, to which the USMCA government procurement chapter still applies, the scope of access to each country's procurement market is largely the same as it was under TPP and even NAFTA. The United States and Mexico each identify the same covered federal entities and government

enterprises as they did in TPP. The thresholds are the same as they were in TPP and NAFTA (though updated to reflect the latest biannual adjustments for 2018 and 2019).

Given the [prospect for a federal infrastructure initiative](#), and the [Trump Administration's interest in strengthening domestic preference requirements](#), one notable aspect of the USMCA procurement outcome is how those requirements might be affected by non-discrimination commitments under the USMCA (for Mexico) and the revised GPA (for Canada). Pursuant to the Trade Agreements Act of 1979, USTR would ensure compliance with those commitments by [waiving application of Buy American preferences](#), which [cover direct procurement by federal agencies](#). However, by excluding “non-contractual agreements or any form of government assistance” from those commitments, the United States maintains the right to keep “[Buy America](#)” and other *indirect procurement* preferences. These cover domestic content requirements tied to federal assistance provided to sub-federal governments to carry out infrastructure projects. Because many infrastructure projects that have been the focus of recent proposals would be achieved through procurements made by recipients of federal assistance, neither the USMCA nor the revised GPA commitments are likely to impede those domestic preferences.

### **C. Sunset Clause**

In the early stages of the USMCA negotiations, the Trump Administration insisted that the agreement include a five-year “sunset clause,” which meant the USMCA would expire after five years unless each country agreed to renew it. Following significant resistance from Canada and Mexico, the final text now includes a sunset clause that would terminate the agreement after 16 years unless each party affirmatively decides to continue the agreement.

Specifically, the [USMCA sunset clause](#) provides that six years after the agreement enters into force, the parties will reconvene to review the operation of the agreement and confirm their desire to extend the agreement for another 16-year period. In that case, the parties will conduct another review at the end of six years. However, if any party does not so confirm at that time, the parties will continue to review the agreement annually until they either reach agreement on extending the USMCA for another 16 years, or the original 16-year term ends and the USMCA terminates in the absence of such an extension.

To be sure, this is the first time a US trade agreement will include a sunset clause, but as a legal matter it provides no additional authority given that any party could always withdraw from the agreement at any time. Furthermore, other agreements have included the helpful notion of regular reviews or “[built-in agendas](#)” for future negotiations. Indeed, [TPP](#) explicitly called for the parties to review the agreement within three years, and every five years thereafter. In so doing, however, it made clear that such review was to be undertaken “with a view to updating and enhancing [the] Agreement, through negotiations, as appropriate.” As in other

agreements that contemplated future negotiations, the TPP review provision was premised on an assumption that the agreement would endure and therefore conveyed an implicit commitment to the viability of this partnership. The USMCA review provision evinces at best an ambivalence towards the continuation of the agreement, emphasizing explicitly the prospect of termination and thereby giving rise to the very uncertainty that trade agreements have traditionally tried to counteract.

In addition to this shift in tone, the USMCA does effectively provide what the Trump Administration was seeking, namely, a short time period in which each party would have to make a determination as to whether to keep the agreement in place. By putting a spotlight on the decision of each party after six years, the Administration has virtually ensured the sort of renewed, high-profile, politicized debate that prompted Canada and Mexico to push back on its original proposal. Including such a decision as part of the regular review of the agreement also raises the question of [whether a President can unilaterally withdraw the United States from a trade agreement](#), which has emerged again recently as President Trump has threatened to withdraw from NAFTA in an attempt to force a congressional vote on the USMCA as is. To what extent the implementing legislation speaks to this authority, and whether Congress will take steps in that legislation or otherwise to ensure itself a voice in such a decision, remains to be seen.

## V. Enforcement

The USMCA largely tracks NAFTA's state-to-state dispute settlement procedures that effectively allow one NAFTA party in a dispute to block the formation of a panel to hear the challenge. This flaw flows from two aspects of the process set out for the disputing parties to propose individuals to serve on the panel.

First, the USMCA, like NAFTA, may allow a defending party in a dispute to prevent the appointment of a panel chair. This is because, under both agreements, where disputing parties cannot agree on a panel chair, the party "chosen by lot" is to select the chair. If that party is the defending party and declines to make such a selection, the process is stalled and no panel is formed to hear the dispute.

Second, the USMCA, like NAFTA, may allow a defending party in a dispute to prevent the appointment of other panelists. This is because, under both agreements, consensus of the parties is required to establish a roster of qualified individuals to serve as panelists, and panelists must "normally be selected from [that] roster." If, for whatever reason, the parties fail to establish a roster by consensus, a complaining party may still propose individuals to serve on the panel that are *not* on the roster. In that case, however, the USMCA generally allows the defending party unlimited peremptory challenges to reject those proposed panelists. Thus, if any USMCA party blocks the consensus needed to establish a roster, a defending party could prevent a dispute from going forward by refusing to accept any off-roster candidates proposed by the complaining party.

The USMCA does improve upon NAFTA by allowing a roster to remain in effect "until the Parties constitute a new roster" rather than requiring the parties to reappoint the roster by consensus every three years. This means that, so long as the parties meet their obligation to establish a roster at the outset under the USMCA, a complaining party will generally be able to propose individuals on the roster as panelists and the defending party will not be able to object. In contrast, the three-year duration under NAFTA meant that the opportunity to prevent the creation of the roster arose three years after approval of the original roster.

The Mexico-US NAFTA sugar dispute in the late 1990s, in which the United States prevented the formation of a dispute settlement panel by failing to appoint a chair or other panelists in the absence of an agreed-upon roster, made these flaws inherent in the NAFTA dispute settlement process [well-known to trade officials in all three countries](#). Yet, rather than correct these flaws and incorporate a number of other procedural improvements included in more recent FTAs, the Trump Administration [pushed to preserve the ability to block panels](#). This new US posture reflects the Administration's view – as seen across a number of its trade policy initiatives – that

US interests are better served by exercising leverage, including the threat of trade actions under Section 301, to compel compliance rather than relying on more legalistic or rules-based dispute settlement processes.

This new posture may also not be surprising given [Ambassador Lighthizer's negative perception of WTO dispute settlement and his expressed fondness for the pre-WTO system](#) under the GATT, where consensus among GATT parties, including acquiescence of the losing party in a dispute, was required to adopt a panel report. It is difficult, however, to square this result with the negotiating objective set out in 2015 Trade Promotion Authority legislation “to seek provisions in trade agreements providing for resolution of disputes...in an effective, timely, transparent, equitable, and reasoned manner.”

Furthermore, dispute settlement under FTAs has rarely been invoked by the United States but stakeholders and Congress have long believed that the enforceability of FTA provisions has been helpful to ensure compliance even without recourse to litigation. This belief would apply even more forcefully with respect to those disciplines that go well beyond existing trade agreements and could not be enforced, for example, in the WTO, such as those on digital trade, biologics, labor, and the environment. Finally, even assuming the existence of sufficient leverage to regularly compel favorable outcomes, it is not clear that businesses and other stakeholders would see such an overtly political and antagonistic process as supporting their long-term goals in foreign markets other than in exceptional cases.

## VI. Implementation

Although negotiations on the USMCA have concluded and President Trump, Canadian Prime Minister Justin Trudeau and former Mexican President Enrique Peña Nieto signed the agreement on November 30, 2018, the agreement must still go through ratification and implementation processes in all three countries before it can enter into force.

### A. United States

In the United States, Congress must pass implementing legislation pursuant to 2015 Trade Promotion Authority legislation. Before that, however, the Administration will first need to resolve concerns and objections raised by members of Congress from both parties, making any vote on the USMCA challenging before the congressional summer recess. And, given the dynamics of presidential primaries, especially following the rhetoric on trade in the 2016 election, Congress is unlikely to consider the USMCA at any point beyond the fall.

Section 232: Democratic *and* Republican lawmakers, [supported by stakeholders including the United Steelworkers](#), are pressing the Administration to [remove the Section 232 steel and aluminum tariffs imposed on Canada and Mexico](#) before Congress considers implementing legislation. [Canada](#) and [Mexico](#) have also made clear that neither government is likely to move forward with USMCA ratification until the Administration ends the Section 232 duties. [Discussions](#) among the governments before the signing of the USMCA as well as discussions held [more recently](#) have failed to reach any resolution with respect to those tariffs. The possibility of new Section 232 tariffs on automotive imports, opposed by many in Congress on a [bipartisan basis](#), further complicates timing for congressional consideration of the USMCA.

Democrats' Substantive Concerns: Even more challenging for prompt implementation of the USMCA in Congress may be the concerns raised by Democrats after taking over control of the House of Representatives. A number of Democrats have emphasized the need to reopen the negotiations in certain areas, such as [pharmaceutical intellectual property](#) or [labor](#), to address their concerns with the outcomes on those subjects. The Administration, as well as the Canadian and Mexican governments, oppose reopening the agreement, but with Democrats seeking a way to put their imprimatur on the USMCA, and given Speaker Pelosi's track record of [exercising Democratic leverage in the House to force a White House to renegotiate trade agreements](#), this remains a distinct possibility.

Democrats' Enforcement Concerns: Separate from concerns about certain substantive disciplines in the agreement are [Democrats' concerns about the enforceability of the agreement](#). From the outset of these negotiations, [Ambassador Lighthizer has sought](#)

[to ensure bipartisan support](#) for the final text in part by aggressively pursuing far-reaching outcomes in areas traditionally highlighted by Democrats, including labor and the environment. While [some Democrats have acknowledged progress in these areas](#), the fact that these new disciplines might not be effectively enforceable (see Section VI on “Enforcement”) risks undercutting the value of what Ambassador Lighthizer achieved. Although [Ambassador Lighthizer has expressed a preference](#) for relying on implementing legislation and/or Section 301 of the Trade Act of 1974 as enforcement mechanisms for the USMCA, questions remain about how the Administration could address these enforcement concerns without reopening the text.

Threat of NAFTA Withdrawal: In December, President Trump [announced](#) that he intended to withdraw from NAFTA as a means of forcing Congress, in particular Democrats, to choose between voting for the USMCA or no North American trade agreement at all. The Administration has since [backed off this threat](#), more recently seeking to pursue constructive engagement with House Democrats to find a path forward.

Given the need for extensive negotiations between Congress and the Administration and the probable need for resolution of the Section 232 tariffs, among other things, a number of members of Congress have already indicated that passing USMCA implementing legislation will likely extend [well into the summer if not longer](#).

## **B. Canada and Mexico**

Mexico presents the most straightforward scenario for implementation, where the agreement must be ratified by a majority vote of the Senate, with no opportunity for amendment, before it becomes directly applicable. Although Mexico’s Senate Majority Leader has [voiced](#) certain concerns, the support of President Andrés Manuel López Obrador is likely to ensure [ratification](#) as his party commands a majority in the Senate and opposition parties also support the USMCA. One factor complicating this scenario is the fact that Mexico must adopt certain labor reforms to fulfill its USMCA commitments, which the government [expects](#) Congress to do before it adjourns at the end of April 2019. US stakeholders have already [begun to express doubts](#) about the bills currently under consideration by the Mexican Congress. Even if the Mexican Congress passes the necessary reforms in April, it will not be able to consider the agreement for ratification until it reconvenes in September.

Canada’s government has already [begun the ratification process](#) by tabling the agreement before the House of Commons in December. Now that the House of Commons has considered and debated the treaty for the prescribed time period under Canadian law, the Cabinet must formally ratify the agreement. The government then will submit implementing legislation to Parliament to be passed by both chambers before receiving [royal assent](#) and becoming law. However, if Parliament does not approve the USMCA implementing legislation by the end of June, when the House and Senate adjourn for summer recess, the bill will have to await consideration by the new Parliament [after federal elections in October](#). [Waiting for the US Congress](#) to act on the USMCA first will undoubtedly result in such a delay.

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