

# Mexico and the United States Reach Preliminary Agreement in Principle in NAFTA Negotiations

August 2018

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On August 27, 2018, Mexican and US officials announced a breakthrough in the renegotiation of the North American Free Trade Agreement (NAFTA). Mexican Minister of Economy Ildefonso Guajardo and United States Trade Representative (USTR) Robert Lighthizer announced a preliminary “agreement in principle” between the two countries, subject to finalization and implementation, on sensitive and non-sensitive NAFTA chapters, including new rules of origin for the automotive sector, the so-called “sunset clause,” seasonal agricultural exports, labor, and dispute settlement provisions. Canadian negotiators arrived in Washington, DC, on August 28 to discuss the details of the new agreement with their US counterparts. Though the United States and Mexico have expressed their desire for Canada to join the agreement, the Trump administration (and the President himself) has indicated that the US Administration will begin the process of finalizing a bilateral agreement with Mexico if Canada does not agree to join the agreement by the end of this week.

We provide below an overview of the most sensitive issues covered by the new agreement in principle, and the next steps in the negotiations and implementation process.

## Preliminary Agreement in Principle

### Stricter Rules of Origin for Automotive Trade

- Regional value content (RVC) requirements will increase from 62.5 percent to 75 percent during a short transition period, *i.e.*, automobiles must contain at least 75 percent originating content in order to qualify for preferential tariff treatment.

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- A new “labor value content” rule will require that at least 40 percent of auto content and 45 percent of heavy truck content be made by workers earning at least \$16 per hour in order to qualify for preferential tariff treatment.
  - According to the Mexican Secretariat of Economy, 68 to 70 percent of Mexican automotive exports to the United States comply with the new rule of origin, which will allow at least part of the automotive trade to continue to flow without disruption.
  - Mexico and the United States will continue discussions regarding the United States’ ongoing investigation of automotive imports pursuant to Section 232 of the Trade Expansion Act.

## **Dispute Settlement**

- Two separate investor-state dispute settlement (ISDS) systems will be implemented. Under the first system, investors that have contracts in the telecommunications, energy generation, oil and gas, and infrastructure sectors will continue to enjoy the full protection of the existing ISDS system. However, investors in other sectors will have access to a limited ISDS system that only covers claims involving expropriation or failure to grant national treatment or most-favored nation (MFN) treatment.
- The United States and Mexico have agreed to eliminate Chapter 19, which provides for binational panel reviews of anti-dumping and countervailing duty determinations made by the governments of the NAFTA parties. However, Mexico will become eligible for exclusions from certain global safeguard remedies imposed by the United States pursuant to Section 201 of the Trade Act of 1974. Canada has previously insisted that Chapter 19 dispute resolution remain a part of any modified agreement.
- The United States and Mexico have agreed not to modify Chapter 20, which governs state-to-state dispute settlement between the NAFTA parties for controversies arising from the application of the agreement.

## **Sunset Clause**

- The initial term of the agreement would be 16 years, with a review after year six. In the sixth year, the parties can decide to extend the agreement for another 16 years. Alternatively, if the parties do not decide to extend the agreement, they will hold reviews in subsequent years with a view to resolving any trade irritants.

## **Labor**

- The agreement will include new, enforceable labor provisions requiring, among other things, that the parties (i) adopt and maintain in law and practice labor rights as recognized by the International Labor Organization, (ii) effectively enforce their labor laws, and (iii) not waive or derogate from their labor laws. USTR also has stated that the Labor chapter will include an Annex on Worker Representation in Collective Bargaining in Mexico, under which Mexico commits to specific legislative actions to provide for the effective recognition of the right to collective bargaining. The parties are expected to review the details of the new labor provisions in the coming days.

## **Agricultural Trade**

- The agreement will maintain existing duty-free treatment of agricultural products.
- A proposal by the United States to establish specialized procedures for trade remedy investigations involving seasonal and perishable goods was withdrawn and will not be included in the agreement.
- Specific provisions on biotechnology and other innovations in agriculture will be included in the agreement.
- The agreement confirms the recognition of “geographical indications” (GIs) for certain products. At the same time, USTR’s fact sheet indicates that the agreement will not restrict market access in Mexico for US cheeses labeled with certain names. It is not clear how this would work in practice, or how it would be reconciled with Mexico’s commitments under other trade agreements.

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## Other provisions

Mexican and US negotiators also agreed to make numerous updates to non-sensitive NAFTA chapters, including (i) sanitary and phytosanitary (SPS) measures; (ii) transparency; (iii) good regulatory practices; (iv) technical barriers to trade (TBTs); (v) e-commerce; (vi) government enterprises; (vii) financial services; (viii) intellectual property; (ix) environment; and (x) energy cooperation.

## Pending Issues: Steel and Aluminum Tariffs, Canadian Participation, and US Congressional Approval

### US Steel and Aluminum Tariffs

Mexico and the United States will continue discussions in the coming weeks regarding the sensitive issue of US tariffs on steel and aluminum imports from Mexico. Currently, Mexican steel and aluminum is subject to a 25 percent duty imposed after the Section 232 national security investigation, and Mexico has retaliated against certain exports from the United States. Mexico also has challenged the US Section 232 duties in the World Trade Organization. The status quo apparently will continue until the governments come to some other agreement, which reportedly could include volume restrictions like those applied to other suppliers, such as Argentina and Korea.

### Canadian Participation in the Agreement

Canadian negotiators returned to Washington on August 28 to begin discussions with the United States regarding Canada's potential participation in the agreement. The Trump administration has indicated that, while it would prefer for Canada to join the agreement, it will begin the process of finalizing a bilateral agreement with Mexico if Canada does not agree to join the agreement by the end of this week. Specifically, USTR stated that by this Friday, August 31, the Trump administration will notify Congress of its intention to sign either (1) a trilateral agreement with the NAFTA parties, or, if Canada refuses to participate (2) a bilateral agreement with Mexico. According to Ambassador Lighthizer, "ideally Canada will be in and we'll be able to notify that. If Canada's not in then we'll notify that we have an agreement with Mexico and that we're open to Canada joining it." Ambassador Lighthizer indicated that President Trump would sign an agreement (whether with Mexico only or with both parties) at the end of the 90-day notification period required under the Trade Promotion Authority (TPA) law (*i.e.*, on November 29, 2018, if the notification is submitted on August 31).

Mexican officials have repeatedly expressed their "strong preference" for a trilateral agreement, but have declined to rule out the possibility of a bilateral agreement with the United States if Canada declines to join. Mexican President-elect Andrés Manuel López Obrador's representative in the NAFTA negotiations, Jesús Seade, stated that "The entire time it's remained clear that [talks] were for a trilateral. It could be a bilateral if [the U.S. and Canada] don't agree, but our strong preference is different[.]" Mexican Foreign Minister Luis Videgaray similarly stated that "[w]e want Canada to be a part of this negotiation, part of this deal. However, we recognize there are variables we don't control, that depend on third parties, that could yield a different result." He further stated that "[w]e will either have a new trilateral deal or a bilateral deal with the U.S ... Mexico will have a free trade deal independent of factors that we can't control."

### US Congressional Approval

The prospects for US congressional approval of a renegotiated NAFTA are uncertain, and the discussions are only beginning. Congressional votes on free trade agreements historically have been contentious, but NAFTA (or whatever name a new agreement may take) faces additional uncertainties, given that the November mid-term elections in the United States may significantly alter the composition of the US Congress. A bilateral agreement with Mexico faces additional uncertainties due to potential controversies over its eligibility for consideration under TPA legislative procedures. Indeed, some have argued that a bilateral agreement with Mexico is not eligible for consideration under TPA procedures because the Trump administration notified and consulted Congress regarding its intention to negotiate a revised NAFTA with Canada and Mexico, not a bilateral agreement with only

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Mexico. Others, including USTR Lighthizer, have argued that a bilateral agreement can proceed under TPA legislative procedures. This particular controversy may become moot depending on the outcome of ongoing discussions with Canada. However, as noted above, Congressional approval of even a trilateral agreement between the United States, Canada, and Mexico is far from guaranteed.

In the meantime, the business community will have to accept a period of uncertainty while these and other issues progress. An optimistic scenario is a new, trilateral agreement that could enter into force in 2019, with the current agreement remaining in place until then. There are many less optimistic scenarios.

Please follow this [link](#) for the full press USTR press release on the agreement in principle with Mexico.

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