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Client Alert

NAFTA on the Brink

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Escalating tensions between the U.S. and Mexico have put the North American Free Trade Agreement (NAFTA) at risk for the first time since its birth in 1994. On January 26, Mexican President Enrique Peña Nieto announced his decision to cancel Mexico's participation in the 'three amigos' meeting in Washington, D.C. The purpose of the planned meeting between the U.S., Mexico, and Canada was to discuss their current trade relationship, including the possibility of renegotiating NAFTA.

With the future of NAFTA uncertain, there are a number of issues and scenarios companies should be aware of.

PRESIDENTIAL AUTHORITY

Whether the president has the power to withdraw the U.S. from NAFTA—and other Free Trade Agreements (FTA)—without congressional approval has been subject to debate. The majority view is that President Trump can unilaterally terminate NAFTA on his own authority to negotiate trade agreements delegated by Congress, and on the basis that NAFTA should be considered an executive agreement. However, a legal challenge may be expected in U.S. courts, whether successful or not. President Trump may also require action by Congress to repeal any amendments to U.S. domestic law pursuant to the NAFTA Implementation Act.

If the U.S. withdraws from NAFTA, duties or other import restrictions may remain untouched for one year after the date the withdrawal becomes effective (the Withdrawal Day), which is 18 months after the date of the notice of termination (the Notice Day). That said, the Trade Act of 1974 allows an increase in tariffs within this timeframe in exceptional circumstances if the president "by proclamation provides that such rates shall be restored to the level at which they would be but for the agreement." The president will also have 60 days after the Withdrawal Day to submit to Congress recommendations as to the appropriate rates of duty for those articles which were affected by the termination.

For more information regarding the president's authority and the challenges he might face in withdrawing from NAFTA and/or other FTAs, please see Crowell's podcast: Trade and Jobs: What Trump Can and Can't Do in the First 100 Days, part of Crowell & Moring's "First 100 Days" Series about the regulatory changes emerging from the White House under the new administration.

ARTICLE 2205: WITHDRAWAL

Article 2205 of NAFTA provides that "[a] Party may withdraw from this Agreement six months after it provides written notice of withdrawal to the other Parties." Importantly, this provision also states that if "a Party withdraws the Agreement remains in force for the remaining Parties." This means that a withdrawal notice either by the U.S. or Mexico does not automatically terminate the Agreement with respect to Canada unless

such notice is explicitly intended to include the other two Parties. In any event, the U.S.' participation in NAFTA would be officially terminated six months after the Notice Day, unless the Parties are able to reach an agreement to reestablish NAFTA before the deadline.

'LAST CALL' FOR INVESTORS

The U.S.' exit from NAFTA would also mean certain investors would lose the Investor-State Dispute Settlement (ISDS) protections contained in Chapter 11 of the Agreement. Although Article 2205 suggests that investors would be able to bring new cases during the six months after the Notice Day, investors will actually have a shorter 90-day window to initiate arbitration pursuant to Article 1119. Once the withdrawal takes effect, U.S. investors would no longer be able to bring claims against Mexican and/or Canadian authorities resulting from government illegal expropriations, or arbitrary or discriminatory actions affecting investments. For more details on ISDS protections, please see Crowell's client alert on the potential implications of NAFTA's termination on Chapter 11.

RESURRECTION OF PAST AGREEMENTS POST-NAFTA

Upon implementation of NAFTA, the U.S. and Canada agreed to suspend operation of the U.S.-Canada Free Trade Agreement (FTA) to coincide with NAFTA's entry into force in January 1994. If NAFTA is revised or repealed, the U.S.-Canada FTA could be re-established. This would require changes to the statutes and regulations of both countries, which in the case of the U.S. would require congressional action.

There has also been discussion about reinstatement of the Automotive Products Trade Act (APTA) after NAFTA. APTA provided for duty free treatment of motor vehicles and original motor-vehicle equipment which are of Canadian or U.S. origin. However, Canada's APTA statutes were challenged at the WTO by Japan and Europe on the basis that they were inconsistent with Canada's obligations under Article III of the General Agreement on Tariffs and Trade (GATT) and Article 3 of the Agreement on Subsidies and Countervailing Measures. Europe and Japan won the dispute in 2001, and as a result, Canada repealed its APTA related statutes and regulations shortly thereafter. Thus, APTA will not be available to fill any gaps left by NAFTA.

CONTINGENCY PLANNING

Although tariff rates would increase with the termination of NAFTA, the cap on the rate increase is the current Most Favored Nation (MFN) tariff rate (*i.e.*, the import duty assigned to non-Free Trade Agreement countries). This rate is below five percent in most instances, although it varies by product.

Termination of NAFTA would reinstate the applicability of traditional import duty programs such as duty drawback with respect to imports from Canada and Mexico. Duty drawback is the refund of import duties paid when those imports are incorporated into a manufactured product that is then exported. NAFTA termination potentially implicates agriculture laws, user fee laws, intellectual property laws, temporary entry laws, sanitary standards, government procurement laws, and state-to-state dispute settlements.

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