

## USMCA's Trade Rules Are Keeping Carmakers On Their Toes

By **Alex Lawson**

*Law360 (April 12, 2021, 8:27 PM EDT)* -- After spending nearly three decades acclimating to the North American Free Trade Agreement's complex web of rules, the U.S. car industry once again finds itself in the middle of a steep learning curve as the U.S.-Mexico-Canada Agreement goes into effect.

The USMCA implemented last year left in place much of the original NAFTA, but some of the new deal's most substantive changes are in the rules of origin for cars and parts. The goal of the deal was to bring more car production into the region by tightening content requirements and introducing new concepts like wage floors.

Rules of origin are already among the most cerebral areas of trade law, with some attorneys likening compliance to running a maze that requires completing a 500-piece jigsaw puzzle before making a new turn. The rules of origin are especially thorny in the automotive sector, where companies are now having to reassess decades' worth of sourcing practices.

U.S. Customs and Border Protection is currently in a "restrained enforcement" period with the new automotive rules, an agency spokesperson said. This requires companies to keep adequate records when making USMCA certifications but is effectively a grace period before the deal is vigorously policed.

That safe harbor period ends on July 1, and carmakers are in the midst of feverish consultations with CBP on compliance as they await final regulations to clear up any confusion on whether their cars, trucks and parts can receive duty-free treatment under USMCA.

"I would say there is motivation on both sides to get to a place where the rules are clearly established so that companies can get their supply chains in order and know what to expect when CBP comes knocking," Sandler Travis & Rosenberg PA attorney Mark Tallo told Law360.

In addition to the yearlong grace period, many U.S. carmakers have inked so-called alternative staging regimes, which allow them as many as five years to comply with the USMCA's rules of origin.

Chief among the USMCA changes is the heightening of the so-called regional value content, or RVC, which dictates how much of a vehicle must be made within North America in order to get a tariff reduction. NAFTA set the RVC threshold at 62.5% for passenger cars and light trucks.

Sourcing parts for automobiles has become an intricate process, and carmakers across the country have

constructed their supply chains to comply with the 62.5% threshold, which will eventually be raised to 75% under USMCA. Now, companies are in the midst of deciding whether to impose wholesale changes to their supply chains or change their value calculations.

For years, the RVC calculation was driven by direct costs of production, namely the cost of the materials used to make the car. But now, some companies are looking to loop in more marginal expenses like indirect materials, shop supplies and other indirect overhead expenses to hit the 75% threshold.

"If today you're only at 70% and you're thinking about getting to 75%, you might be thinking, I pay engineers a lot of money, they don't touch the vehicles, but they are part of the cost of production, maybe I should be adding that in," Barnes Richardson & Colburn LLP partner Lawrence Friedman told Law360.

Wages are also top of mind for a number of car company compliance officers and attorneys as they grapple with the USMCA's landmark change: the addition of a so-called labor value content requirement, which requires that at least 40% of the manufacturing labor incorporated in a car, and 45% for trucks, must have a wage rate above \$16 per hour.

While the raising of the RVC is a challenge, it still centers on the familiar task of calculating the money that goes into the creation of a vehicle. By contrast, no U.S. trade deal has ever required companies to definitively assert that a certain percentage of workers were earning a specific wage.

This creates a host of new compliance challenges that automakers are still ironing out, according to Crowell & Moring LLP partner David Stepp.

"It's a whole new regime of data collection. I see labor value content as the most unique and challenging, because that sort of information has never been collected before," Stepp told Law360. "Some costs were collected under NAFTA, but not this granular level as to what the hourly wage was for specific workers."

Stepp said this burden is being felt by downstream parts suppliers, as carmakers have begun to inquire about the wages paid to their workers and how it can be folded into the overall wage requirements for the car itself.

"The parts manufacturers and the vehicle manufacturers are swimming around trying to see what actually is going to have to be made with this \$16 per hour," he said.

The USMCA also creates certain wrinkles for manufacturers of electric cars. The agreement says that in order for those vehicles to qualify as originating within the region, their batteries must qualify, as well.

Electric vehicle capacity in the U.S. is limited, and car companies are scrambling to ensure they can meet the requirement. A recent \$1.8 billion settlement between two South Korean battery makers will cushion the blow, as the producers were facing a potential ban on batteries and parts imported by SK Innovation Co. that would have hampered sourcing efforts. The last-minute settlement averted a potential import ban and will allow an SK Innovation plant in Georgia to go forward, maintaining a crucial hub for U.S. automakers.

"The settlement likely makes longer-term planning easier," Friedman said.

The Trump administration's aggressive tariff campaign against China is also casting a long shadow over car companies grappling with USMCA compliance. As the deal has taken hold, some auto parts importers are facing a 25% levy on goods imported from China, even though they classify for duty-free treatment under USMCA.

At the core of the industry's discomfort is that exemption from the China tariffs require a "substantial transformation" of components into a new product that is different from the USMCA rule of origin.

"This can be an issue for auto parts suppliers because products often move in and out of the U.S. for additional processing. As a result, companies not only have to look at the processing to determine whether it satisfies the USMCA rules of origin but also whether the processing results in a substantial transformation to avoid the imposition of [the China tariffs]," Tallo of Sandler Travis said.

Most attorneys agree that as carmakers await the full enforcement of the USMCA, they would be wise to review their entire supply chain to be sure they're not tripped up by the agreement's new rules.

"Producers should continue to evaluate and update their solicitation process as they continue to solicit USMCA certifications from their suppliers," Arent Fox LLP partner David Hamill said.

--Editing by Alanna Weissman and Nicole Bleier.