



CLIENT ALERT

October 7, 2019

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INTERNATIONAL TRADE

WILL USMCA BE THE TRICK OR TREAT IN OCTOBER 2019?

by Daniel D. Ujcz

Summary

There are more than the necessary 218 “yea” votes for ratification of the United-Mexico-Canada Agreement (USMCA) by the U.S. House of Representatives. However, Speaker of the House Nancy Pelosi will wait for the “green-light” from labor before advancing the USMCA implementing bill in Congress.

Two key issues impact whether Speaker Pelosi will proceed with the vote. The first is the rising tide of impeachment. While there are strong calls to keep impeachment and USMCA on separate tracks, there may not be enough oxygen on Capitol Hill to complete USMCA in the 20 legislative days until the U.S. Thanksgiving recess and the inevitable takeover of 2020 politics. The second—and perhaps of greatest importance—Mexico’s budget did not clearly allocate the funding for domestic labor reform implementation. The budget actually cut labor/justice ministry spending by nearly 40%. Mexico is sending delegations to explain to U.S. officials that the labor reform is buried in the budget’s other areas, and U.S. House Ways and Means Chairman Richard Neal (D-MA) will be in Mexico on October 8 to discuss. These issues, coupled with an ongoing United Auto Workers (UAW) strike, make the calendar very challenging. Indeed, we see no scenario where a Democrat-controlled U.S. House of Representatives would seek ratification of a trade deal while UAW members were on the picket lines.

United States Trade Representative (USTR) and the Democrats’ USMCA negotiating teams nevertheless will make progress in their negotiations over the coming weeks. With this homework nearly complete, Speaker Pelosi then will take the temperature of Mexico’s progress on labor reform, labor’s views, impeachment, and a number of other policy and political issues. The end of October likely will be “trick or treat” for the USMCA. If it is the latter, the process may move rather quickly (by Washington standards) but there may be some pushback (e.g., disapproval resolutions) from more progressive members of the Democrat caucus. It nevertheless will pass if brought to the floor by Speaker Pelosi. However, if the result is a “trick,” we do not anticipate ratification until the lame duck of 2020, depending on the results of the U.S. elections.

In order to provide insight into these issues, the following provides a detailed analysis of the progress and processes in the three countries. We remind companies that following the vote for USMCA passage in the three countries (whenever that may occur), the next step will be the development of the Uniform Regulations. It will be critical for companies to follow those developments as the Uniform Regulations will be the actual parts of USMCA that will govern trade in North America and be used on daily basis.

Report

MEXICO: Mexico’s Senate of the Republic ratified *El Tratado entre*

México, Estados Unidos y Canadá (T-MEC, Mexico’s version of the USMCA) on June 19, 2019. The Senate published on July 29, 2019 its decision to approve the T-MEC Protocol in the Official Gazette of the Federation, making Mexico the first country to officially notify the other parties that it had completed its internal procedures for entry into force. The publication served two purposes: (1) reinforcing to the U.S. that Mexico had ratified the T-MEC in its present form and that it would be unwilling to make any major changes to the agreement/“re-open up the agreement”; and (2) reminding investors that Mexico’s trading relationship with North America was relatively stable given that Mexico was tip-toeing with recession level economic numbers in June/July. Mexico’s President, Andrés Manuel López Obrador (AMLO), also hosted several delegations over the summer relating to T-MEC and Mexico’s domestic labor reforms including those from the U.S. House of Representatives (CODEL), Canadian officials regarding the provision of labor technical assistance, and the AFL-CIO. While none of the U.S. delegations emerged with a definite “Yea” on T-MEC/USMCA, the positive news was that there were no surprises in terms of new proposals for Mexico to undertake regarding labor and enforcement. In short, changes to USMCA being discussed by the U.S. Congress and the White House in terms of labor and enforcement likely will set the contours of the deal.

All eyes are on Mexico’s implementation of the domestic labor reforms passed in May 2019. Mexico’s “roadmap” for these reforms requires review of approximately 600,000 existing collective bargaining agreements as well as the establishment of a series of labor tribunals throughout the country to address the backlog of nearly one million labor claims. These efforts will require resources. AMLO’s expenditure budget was presented to the Mexican Congress’ lower chamber on Sept. 8, which allegedly included funds to implement Mexico’s labor reforms. However, these budgetary provisions were not readily apparent. Mexico is now explaining its budget on the U.S. Capitol Hill and Chairman Neal will be in Mexico on October 8. This will be closely examined by the U.S. Congress and labor organizations. Mexico’s lower chamber will have until Nov. 15 to approve the budget. This is an area that we will be closely monitoring over the coming weeks.

CANADA: The Prime Minister of Canada introduced on May 29, 2019 *An Act to implement the Agreement between Canada, the United States of America and the United Mexican States* (CUSMA) and the bill advanced to Second Reading and Referral to Committee on June 29, 2019. The next steps of the process would include debate in committee (which could take only a few days), a third reading, votes in the House of Commons, then the bill would move to the Senate of Canada. While passage was expected, the Government of Canada emphasized a strong desire to move in tandem with the U.S. Congress, which did not pass the USMCA implementing legislation prior to Parliament’s summer recess. While the Prime Minister advised that Parliament could be recalled for a special session should the U.S. Congress pass CUSMA over the summer, this contingency did not arise. Canada now has “dropped the writ” for its October 21, 2019 federal elections which terminates all pending legislation in Parliament. Consequently, Canada will be unable to address CUSMA prior to the election and the next government will have to introduce new legislation to implement CUSMA, likely not before 2020. Most commentators expect a minority government following

Canada's election; however, there does not appear to be a serious threat to CUSMA implementation at this time (although the resurgent New Democrat Party, a potential key player in a minority government, recently threatened to renegotiate the deal). Canada likely will be the last to pass CUSMA implementing legislation in early-2020, should the U.S. move first. The minority government scenario, where the NDP or Green Party could become key majority makers, may make the debate surrounding CUSMA a bit more controversial. Yet, a USMCA modified and passed by a Democrat-controlled U.S. House of Representatives likely will alleviate the concerns of left-leaning parties.

UNITED STATES: Pursuant to the Bipartisan Congressional Trade Priorities and Accountability Act of 2015 (TPA-2015), the next procedural step in the U.S. is the introduction of the USMCA implementing legislation in the U.S. Congress. TPA-2015's expedited procedures (aka "fast track") commence upon introduction of the bill to the relevant committees of jurisdiction (U.S. House Ways and Means Committee and Senate Finance Committee). The U.S. House Ways and Means (and potentially other committees) have 45 days in which to consider the implementing bill or it is automatically discharged to the full House of Representatives for limited debate and vote. The Senate may concurrently or consecutively consider the implementing legislation for no more than 45 days. As a result, the expedited procedures provide for a maximum of 90 session days where the implementing bill may be voted on by both chambers of the U.S. Congress without any amendment. There are approximately 20 session days scheduled in the U.S. House of Representatives prior to U.S. Thanksgiving; therefore, introduction of the implementing bill needs to occur within the next several weeks. There is little chance that the USMCA will pass Congress if introduced later than the end of the calendar year 2019 as 2020 Presidential politics will be in full swing.

Speaker Pelosi and labor are the determining factors in whether the USMCA implementing legislation will be introduced in the fall 2019 session. Speaker Pelosi has established a process to address four broad issues: (1) Labor, (2) Enforcement, (3) Biologics/Prescription Drugs, and (4) Environment. The Speaker appointed 8 members of the Democrat caucus (2 per subject-matter area) to lead discussions with the United States Representative (USTR), with Chairman Neal serving as the ninth member. The 8 members reflect the ideological diversity in the Democrat-caucus. As a result, if these working groups are able to achieve a series of deals with USTR, Speaker Pelosi will likely allow the USMCA vote to proceed.

There is a universal refrain that all are working "get to yes" and that the discussions between the working groups and USTR have been constructive. The parties have exchanged proposals and counter-proposals. Attention is being given that most of the negotiations have been done in secret, as opposed to public/leaks. This is deemed a sign of good faith and progress. While there has been a good deal of "constructive" talk, there has not been much of the "complaining" or "crying" that will be the necessary cover for both ends of Pennsylvania Avenue to make this deal. We will need to see those tears before we see the bill.

On the procedural side, the majority of any potential changes can be done through the implementing legislation. Changes to enforcement—particularly, discussions surrounding USMCA's dispute settlement mechanism—may require a narrow reopening of the text of the agreement. There may be revisions to the text of the agreement which may require changes in Mexico (which has ratified the deal) and Canada (where implementation remains pending) but these would be narrow in scope. There are a number of creative ways to make these changes without a large scale reopening of the deal.

Regarding these substantive changes, the potential scenarios for the USMCA implementing bill this fall include **BOTOX**[®], **BARGAINING**, or **BLAME AND BUMP**.

- **Botox**[®]—The Democrats are working "to get to yes." There are a significant number of Democrats who want to implement USMCA, but for policy and political purposes require substantive changes. There is true bargaining taking place, not just Botox[®] or other cosmetic changes. Much of the argument for "no deal" this fall suggests that Speaker Pelosi will not give President Trump a political win. While true, this emphasizes that this is more than Botox[®]. The Democrats need to put their "stamp" on the deal. The bargaining outlined below is designed to achieve a USMCA that is as much a Democrat deal as President Trump's deal. If the parties are unable to secure a Democrat imprimatur on USMCA, there will be no deal. Companies must acknowledge this fact and recognize that the USMCA that was signed in November 2018 will not be the USMCA that emerges in November 2019 (or beyond).
- **Bargain**—

Labor A key factor regarding the introduction of the implementing bill will be whether or not labor organizations such as AFL-CIO support USMCA. The labor reforms introduced into Mexican law this year and required by USMCA seems to have increasing support from Democrat members as Mexico's government and business community has done a good job of explaining those reforms. The issue is no longer the substance of those laws but Mexico's roadmap for implementation. The CODEL that visited Mexico City in July came back to Washington, D.C. with a greater appreciation of the enormity of this task. It remains to be seen whether Democrats and labor organizations can get to yes on implementation. Our view is that labor was willing to get to yes but that they will use USMCA in the UAW negotiations and stretch the process out a bit to demonstrate that they squeezed every last drop out of the White House and Mexico. However, Mexico will now need to provide clarity over the budget allocations to implement those reforms. If Mexico is unable to demonstrate that the labor reforms will be funded and potentially implemented, there is little chance that labor will support the deal.

Enforcement Similarly, bargaining regarding enforcement over labor and other dispute resolution is the key touchpoint for Democrats. The prior government to government dispute resolution system in NAFTA was widely recognized as falling short largely due to the potential for panel blocking—that is, a country could prevent the dispute over the

agreement from ever being resolved by failing to appoint its arbitrator to panel. There are a number of creative ways to resolve this issue and Mexico and the U.S. are talking about workarounds. Building off a proposal by U.S. Senators Wyden and Brown, Democrats and USTR purportedly have reached agreement regarding the use of bi-national inspection teams arising from labor and environmental violations, and cleared up confusion arising from the *Guatemala* case that requires such violations to be systemic. USTR purportedly has agreed to language where one instance could be deemed a “systemic” labor violation. Companies having operations in Mexico need to closely watch these developments in terms of labor/HR practices.

Biologics/Prescription Drugs Progress appears to be advancing in the biologics/prescription drugs area. U.S. law presently provide intellectual property protection and market exclusivity for data biologics to pharmaceutical companies for 12 years, with the Canadian law providing 8 years and Mexico 5. The parties reached in USMCA a deal at 10 years, which is more than the 8 years Canada and Mexico were willing to go in the TransPacific Partnership (TPP, now CPTPP). Indeed, the TPP provisions remain suspended given the dispute on this issue. Pharmaceutical manufacturers claim this “win” in order to provide return-on-the-investment needed to continue to invest in this potentially life-saving R&D, where progressives are challenging the provision as a give-away to pharmaceutical companies that will raise the cost of prescription drugs and delay the issuance of more affordable generics. USTR Robert E. Lighthizer has proposed using a footnote in the text to assure Democrats that nothing in the USMCA will prevent Congress from addressing prescription drug prices (which was arguably in issue in Medicare Schedule D reform a few years back). Democrats are skeptical that will be enough and have asked for the complete removal of the provision from USMCA. Big Pharma recently utilized a former Obama-era USTR official to calm fears among Democrats that the biologics provision will not increase prescription drug prices. This is a critical issue as more than 150 Democrats have come out against the USMCA biologics provision, including approximately 1/3 of the New Democrat/Blue Dog Democrat caucus, that are the moderate Democrats that will form the core of the “yea” votes. USTR now purportedly has agreed to a ratchet-down provision, where if the U.S. Congress reduces the biologic provision under U.S. law to below 10 years, this will become the new USMCA threshold. Democrats purportedly have backed away from their demand of the complete removal of the biologics provision. This may resolve the issue but monitoring of the reactions to the details of this proposal will be critical to Speaker Pelosi’s October temperature check.

Environmental Environmental issues will be the most straightforward bargain to reach. There are several issue regarding water quality at the US-Mexico border and battery recyclers that may have gone to Mexico to escape EPA regulations. If the issues remain narrow, there can easily be a deal on the environment. There purportedly is agreement between USTR and the working group to address wastewater treatment issues in San Diego-Tijuana and provide funding to the North American Development Bank and Border Infrastructure Fund financing. More than 100 Democrat members recently issued a letter calling for climate change to be in the USMCA. However, the overwhelming majority of

these were “Nay” votes regardless of the outcome of the negotiations.

Grand Bargain It must be emphasized that USMCA ratification may be part of a larger bargain between the White House and the U.S. House of Representatives. Recent reports have suggested Speaker Pelosi may use the USMCA as a bargaining chip for pension reform legislation (which could assist in bringing labor on-side), gun reform, and prescription drugs affordability. While these sound good in theory, one wonders if there is the time for this type of horse-trading. Also, a concern arises if one needs to then start counting Republican “yea” votes on USMCA that may move to “Nay”.

- **Blame & Bump**—Given these timing and political challenges, the temperature check may result in blame and bump scenario. Our view on the ground is that there is a great deal of trade fatigue in the heartland and manufacturing Midwest. Moderate voters want to see Congress and the White House “do something on anything” which weighs in favor of a deal. Unfortunately, moderates do not fund campaigns and get energized a year before a presidential election. The bases will matter with 2020 politics playing a larger role in USMCA with each passing day during the fall. There is going to be a strong incentive to “blame and bump” the USMCA to lame duck 2020 or the new Congress in 2021, where the President can blame Speaker Pelosi and Speaker Pelosi can blame the President, and each can raise a good deal of campaign contributions in the lead up to 2020. Impeachment only makes this more likely. Meanwhile, North America will miss the opportunity to remain the most economically stable and competitive market in a world full of uncertainty.
- **Blow it up?** The three options—Botox®, bargain, or “blame and bump”—all potentially serve to stave off a “blow it up” option by President Trump. There could be a scenario where President Trump starts the at-least-six-month-NAFTA-withdrawal clock to show that he is tough negotiator and make this Speaker Pelosi’s problem. After 5 months, 3 weeks and 4 days, Congress and, or, the courts will step in and likely delay the withdrawal. The question is how much economic damage will be caused during this disruption? The President knows that his voters in the heartland and manufacturing Midwest cannot take another hit—we hope. The view inside the beltway that the President needs USMCA to win this part of the country is overblown. This part of the country will reinforce to the President that he has his political “win” on USMCA. He did his part, it is now Congress’ problem, and the blowing up of NAFTA is no longer a strong selling point. Getting the deal done now (or even later) and keeping the economy humming is a larger political win than causing disruption for the sake of leverage. We do not see a scenario where there is neither NAFTA nor USMCA through the November 2020 election.

Conclusion

The whip count in the U.S. Congress requires movement by labor. Speaker Pelosi will need 218 votes in the U.S. House Representative to pass the implementing bill by a simple majority. Should the vote

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be held today, there are more than 218 votes. The Republicans will provide approximately 180-190 votes and Speaker Pelosi easily has the remaining Democrat votes to reach a majority. Of the more than 100 members of the New Democrat/Blue Dog Caucuses, there are approximately 40-50 "yea" votes to provide the majority. Additionally, once the Speaker allows the bill to proceed, there likely will be a number of votes to support the Speaker's bill, while allowing the nearly 100 members of the progressive caucus and nearly three dozen New Democrats/Blue Dog Coalition members who object to USMCA on the biologics provision grounds to vote "no."

However, Speaker Pelosi will not pass President Trump's USMCA by squeaking the USMCA over the simple majority finish line. She will desire momentum around the lines of 130 or so Democrat votes and virtually all Republicans as with the border bill in late June. The only way to create this surge of momentum is for labor to provide those additional votes. Labor need not bless USMCA, but it cannot burn the deal. While impeachment will receive all the attention, USMCA followers should watch the signals from labor. The UAW strike, Mexico's budget for labor reforms, and whether labor unions support any changes to the enforcement provisions of the USMCA (e.g., binational inspection panels) are the key factors determining if the climate is right to advance USMCA. Will labor provide the sweets to advance the deal or provide the trick that pushes the USMCA into late 2020? Trick or treat.

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Daniel D. Ujcz is a Of Counsel and Cross Border (Canada - U.S.) Practice Group Chair, in Dickinson Wright's Columbus office. He can be reached at 614-744-2579 or dujcz@dickinsonwright.com.