THOMPSON HINE

International Trade Update

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Panel Concludes Automakers May Continue Core Parts "Roll-up" to Meet USMCA's RVC Passenger Vehicle and Light Truck Requirements

Notable Impacts

- A U.S.-Mexico-Canada Agreement ("USMCA" or "Agreement") Chapter 31 Dispute Resolution Panel ("Panel") concluded that automakers may continue to use the longstanding practice of "roll-up" when calculating the percentage of North American-originating materials used in the production of core automotive parts (e.g., engines) that is subsequently factored into the computation for determining the total amount of originating content (the "regional value content" or "RVC") for passenger vehicles and light trucks.
- The Panel flatly rejected the strict U.S. interpretation indicating that "roll-up" did not apply to core parts when calculating the total regional value content for passenger vehicles and light trucks, and instead accepted the views of Mexico and Canada that the plain language of the USMCA supported the continued application of "roll-up."
- "Roll-up" is the process that determines when a good adequately reaches a certain RVC level to be deemed "originating" under USMCA (i.e., 72%). It then will be considered as 100% originating at all subsequent stages of production. In the present dispute, the Panel confirmed that once a core automotive part is determined to be originating by reaching the 72% RVC threshold, it is thereafter considered 100% originating content when subsequently calculating the total RVC for the entire passenger vehicle or light truck.
- The United States, Canada and Mexico (the "Parties") have 45 days from when they received the December 14, 2022 Final Report to accept and comply with the decision by negotiating a resolution according to its terms. Resolution can include "elimination of the non-conformity," the "nullification or impairment" of the non-conformity perhaps by "the provision of mutually acceptable compensation," or "another remedy" agreed upon by the disputing parties.
- If the three governments do not reach resolution, USMCA authorizes Mexico and Canada to take remedial measures against the United States by suspending USMCA benefits of "equivalent effect" for the U.S. automotive sector and potentially other sectors of the U.S. economy. The U.S. can challenge such retaliation which would prompt the Panel to reconvene and decide on the remedial measures within 3–4 months.
- The United States previously signaled it would issue new guidance on the USMCA automotive rules of origin and was likely waiting for the release of this Panel decision before publishing the new guidance.
- It is an open issue whether the Alternative Staging Regime approval letters that the United States issued to various vehicle producers will remain in effect. With multiple USMCA disputes underway between Canada, Mexico and the United States on issues ranging from dairy to energy, the United States may attempt to maintain some leverage in those disputes by not immediately implementing this Panel's decision.
- While the Panel decision is limited to the issues presented, the rationales presented in the Final Report provide guidance (and potentially comfort) to vehicle producers that the interpretation of the USMCA Automotive Rules of Origin will be limited to the plain text of the Agreement.
- Toward the end of the first quarter of 2023, original equipment manufacturers ("OEMs") and suppliers are expecting critical U.S. government guidance regarding

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USMCA, the Inflation Reduction Act ("IRA") and Build America, Buy America ("BABA"). It is highly likely that there will be differing "originating" and "qualifying" standards under these separate agreements and legislative approaches. The United States may be able to achieve the result it was seeking in this USMCA dispute by using similar rationales in the IRA and BABA. This will create different, and potentially inconsistent, standards for automakers and suppliers seeking to design and implement sourcing and compliance programs.

Introduction

On January 11, 2023, a USMCA Panel publicly issued its Final Report in the automotive rules of origin dispute brought by Mexico and Canada, concluding that the United States breached USMCA Article 8 (relating to Alternative Staging Regimes) and misinterpreted Article 4.5 (the "roll-up" provision) and Article 3.0 of the Automotive Rules of Origin (pertaining to Regional Value Content for Passenger Vehicles, Light Trucks and Parts Thereof).[1] While the Panel provided a straightforward interpretation of the Agreement, an understanding of the USMCA's complex Automotive Rules of Origin ("Auto ROO") is necessary for OEMs and suppliers to understand the implications of this Final Report.

RVC Certification, Vehicle Certification and Parts Certification

The USMCA requires vehicle producers[2] to provide three (3) certifications to obtain preferential tariff treatment under the Agreement: (1) the RVC certification;[3] (2) the Steel and Aluminum Certification;[4] and (3) the Labor Value Content ("LVC") certification.[5] The Panel recognized that the Parties agreed that vehicle producers must meet these three (3) basic certification principles.[6] The Parties differed, however, on the application of the RVC certification.

Article 3 of the Auto ROO establishes the RVC certification requirements and the relevant staging regimes (i.e., "phase-in" periods) required for passenger vehicles and light trucks.[7] To meet the current USMCA RVC certification requirement for passenger vehicles and light trucks, a vehicle producer must certify that the finished, assembled vehicle contains at least 72% of USMCA originating materials (and no more than 28% non-USMCA originating materials).[8] The RVC requirement will increase to 75% on July 1, 2023 and remain at this high threshold.

Notably, the RVC certification requirement only applies to the final, assembled passenger vehicle and light truck seeking to claim preferential tariff treatment when shipped and exported within North America (i.e., "vehicle certification"). However, to determine whether a passenger vehicle or light truck meets the vehicle certification requirement, the vehicle producer must review the Auto ROO for each automotive good/part used in the production of the vehicle and determine the specific applicable ROO requirements for that automotive good (i.e., "parts certification"). This parts certification is critical because the USMCA requires that certain defined "core parts,"[9] "principal parts,"[10] and "complementary parts"[11] must meet RVC requirements higher than those required in the USMCA's predecessor, the North American Free Trade Agreement ("NAFTA").

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[1] *See Automotive Rules of Origin*, Panel Review Number USA-MEX-2022-31-01, USMCA Chapter 31 (Final Report Issued to Parties on December 14, 2022; Public Version of Final Report Issued January 11, 2022) (hereinafter "USMCA Auto ROO Final Report at __").

[2] While the Auto ROO references "vehicle producers" in multiple sections, including in the Steel and Aluminum Certification (*see*, *e.g*., Arts. 6 and 7), the term is not defined in the USMCA. The USMCA nevertheless defines the term "producer" as "a person who engages in the production of a good." *See* USMCA, Chap. 4, at Art. 4.1. The term "vehicle" is also not defined in the USMCA. *See generally*, U.S. Customs and Border Protection, USMCA Implementing Instructions, June 30, 2020, available at https://www.cbp.gov/sites/default/files/assets/documents/2020-Jun/USMCA%20Implementing%20Instructions%20-%202020%20Jun%2030%20%28Finalv1%29.pdf.

[3] *See* USMCA Auto ROO at Arts. 3 and 4; Harmonized Tariff Schedule of the United States ("HTSUS") GN11(k)(iii).

[4] *See* USMCA Auto ROO at Art. 6; HTSUS GN11(k)(v).

[5] *See* USMCA Auto ROO at Art. 7; HTSUS GN11(k)(vi).

[6] *See* USMCA Auto ROO Final Report at 8, para. 52.

[7] *See* USMCA Auto ROO at Art. 3; HTSUS GN11(k)(iii).

[8] *See* HTSUS GN11(k)(iii)(A). Article 3(1) of the Auto ROO includes similar language but varies as the July 1, 2020 "in force" date of USMCA had not been established.

[9] *See* USMCA Auto ROO at Art. 3(2), (3), (7); HTSUS GN11(k)(iii)(B), (C), (G)–(I).

[10] *See* USMCA Auto ROO at Art. 3(4); HTSUS GN11(k)(iii)(D).

[11] *See* USMCA Auto ROO at Art. 3(5); HTSUS GN11(k)(iii)(E).

Parts Certification for Core Parts

The issue before the Panel addressed the connection between the "parts certification" calculations for core parts and the inclusion of those calculations in the "vehicle certification." The USMCA provides a precise list of core parts for passenger vehicles and light trucks in Table A.1 of the Auto ROO, which includes engines, gear boxes, body stampings, chassis, and other major components.[12] A key U.S. objective during USMCA negotiations was the imposition of high RVC requirements for these core parts. Accordingly, the current RVC requirement for core parts generally is 72% (staging to 75% on July 1, 2023), and each core part may also have additional requirements at a product-specific level.[13]

The Parties agreed to these thresholds for meeting the parts and vehicle certifications. They disagreed, however, on how to "count" the value of the non-originating material ("VNM") in the parts certification process for the subsequent calculation of the vehicle certification. For example, when a core parts producer determines that the part meets the 72% parts certification threshold by having 78% USMCA-originating materials, the question is whether to include the 22% VNM (i.e., "non-North American materials") in the subsequent vehicle certification calculation. In other words, what should happen to the 22% VNM?

Roll-Up

Article 4.5(4) of the USMCA continues the longstanding practice of "roll-up" utilized under NAFTA and other free trade agreements.[14] For the USMCA's "roll-up," once a good is determined to be originating under USMCA Annex 4-B, which provides the product-specific rules of origin (PSROs) for all goods by Harmonized System ("HS") code[15] and/or the Auto ROO, that good is deemed to be 100% "originating" in all subsequent production processes and calculations. As in the previous example, if the Auto ROO requires a core part to have a 72% RVC and the producer determines that 78% of it is made from originating (i.e., USMCA qualifying) materials, the VNM (i.e., the remaining 22%) is disregarded in subsequent calculations when the good is incorporated into the production of a larger component. On a practical level, when the vehicle producer prepares the bill of materials ("BOM") for that subsequent/downstream product, the vehicle producer may then attribute a 100% content value of originating materials for that initial core part. In other words, under "roll-up," once a good becomes a citizen of "USMCA-land" (i.e., it is "originating"), it then becomes a 100% citizen going forward.

The U.S. Position

Mexico, Canada and a significant portion of the automotive industry interpreted the Auto ROO to include the "roll-up" provisions particularly because Article 3.6 of the Auto ROO provides that "[f]or the purposes of calculating the regional value content under paragraphs 1 through 5, Article 4.5 (Regional Value Content) . . . app[ies]."[16] However, the United States disagreed, arguing that the origination requirements for core parts in the Auto ROO were separate from the vehicle certification requirements and thus precluded the use of "roll-up." The practical effect of the U.S. interpretation was that vehicle producers would have to include the VNM (i.e., the 22% in the previous example) when calculating the RVC for the final, assembled vehicle. This approach presented substantive and procedural challenges for vehicle producers and suppliers because many USMCA sourcing decisions were based on the potential use of "roll-up" (i.e., some vehicle badges may not meet the vehicle certification requirements). Moreover, certification/compliance/tracking procedures were also conditioned on the use of "roll-up" and would otherwise need to be renovated to account for this interpretation.

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[12] *See* USMCA Auto ROO at Table A.1.

[13] *See* USMCA Auto ROO at 3(2); HTSUS GN11(k)(iii)(B), (C).

[14] *See* USMCA Art. 4.5(4) ("Each Party shall provide that the value of non-originating materials used by the producer in the production of a good shall not, for the purposes of calculating the regional value content of the good under paragraph 2 or 3, include the value of non-originating materials used to produce originating materials that are subsequently used in the production of the good.")

[15] *See* USMCA Art. 4, Annex 4-B.

[16] *See* USMCA Auto ROO at Art. 3(6).

Alternative Staging Regime

Given these implications, Mexico (later joined by Canada) commenced the Chapter 31 Dispute Resolution process in August 2021 before the United States implemented its strict interpretation. As the Panel indicated, none of the Parties could say with any certainty whether vehicles currently were imported in accordance with the U.S. interpretation.[17] The United States only advanced its interpretation in letters approving Alternative Staging Regime ("ASR") proposals submitted by vehicle producers. Article 8 of the USMCA provides an ASR mechanism as a means for vehicle producers that were or are unable to meet USMCA's staging periods to request a differing phase-in schedule under certain criteria. While the United States approved all requests for ASRs submitted from late 2020 to early 2021,[18] the United States did so on the condition that the vehicle producers accepted the U.S. interpretation of "roll-up" as inapplicable for core parts when making the vehicle certification.[19] The Panel determined that this U.S. condition breached Article 8 by requiring vehicle producers to comply with criteria not otherwise included in Article 8. According to the Panel, the United States could only condition its approval of the ASRs on the criteria listed in Article 8 pertaining to RVC Certification, the Steel and Aluminum Certification, and the LVC Certification.[20] The additional criterion — or the "surprise" presented by the United States — was a breach of the Agreement.

Silence is Golden, and Once Originating, Always Originating

The Panel then engaged in a straightforward analysis of the plain text of the Agreement, which led the Panel to reject the U.S. interpretation. According to the Panel, all Parties agreed that if the Auto ROO stopped at Article 3.6, there would be no question that "roll-up" would be included in the calculation of vehicle certification.[21] The United States had countered that Articles 3.7–3.9 of the Auto ROO, which provide another table (Table A.2) for core parts and alternative mechanisms for calculating RVC, preclude the use of "roll-up."[22] The Panel, however, recognized that while these sections provided additional means for determining the parts certification for core parts, there was no limitation on the use of the Article 4.5(4) "roll-up" provision.[23] The "silence must be considered," the Panel wrote, and "[o]nce the core parts are found to be originating, Article 4.5.4 permits the producer to roll-up the RVC of the core parts when calculating the vehicle RVC."[24]

An additional determination the Panel made that may have some persuasive effect in future interpretations of the Auto ROO was the Panel's conclusion that "originating" in one section of the Agreement means "originating" throughout the Agreement, including the Auto ROO, unless otherwise modified by the plain text.[25] As USMCA experience has demonstrated, there are multiple areas in the Agreement where the term "originating" is used without further definition. The Final Report thus may provide support for a vehicle producer's exercise of reasonable care that "originating" actually means "originating" under the applicable PSRO and Auto ROO.

To Comply, or Not to Comply: That is the Question

Pursuant to USMCA Article 31.18, the disputing parties have 45 days "to agree on the resolution of dispute," which can

[17] *See* USMCA Auto ROO Final Report at 10, paras. 59–61.
[18] *See* USMCA Auto ROO Final Report at 9, para. 58.
[19] *See* USMCA Auto ROO Final Report at 18–19, para. 97.
[20] *See* USMCA Auto ROO Final Report at 18–19, paras. 94, 97.
[21] *See* USMCA Auto ROO Final Report at 23–24, para. 123 ("To put it another way, if Article 3 had stopped at paragraph 6, producers would have been able to calculate the RVC of passenger vehicles and light trucks [and, as an intervening step, the RVC of the core parts in Table A-1] without needing anything further. Indeed, again, this does not appear to be disputed by the Parties.").
[22] *See* USMCA Auto ROO at 3(7)–3(9) and Table A.1; USMCA Auto ROO Final Report at 24–26, paras. 124–138.
[23] *See* USMCA Auto ROO Final Report at 27, paras. 124–138 ("That silence must be considered, however, in light of Article 4.5.4. The Panel considers there is no limitation in the Agreement on the scope of Article 4.5.4. Article 4.5.4 does not need to be repeated in Article 3 to be applicable to the goods discussed therein, nor is there any carve-out to except the core parts provisions in Articles 3.7 through 3.9. It is undeniable that core parts, whether denoted in the terms used in Table A.1 or the terms used in Table A.2, are included in the final vehicle.").
[24] *See* USMCA Auto ROO Final Report at 28, para. 150.
[25] *See* USMCA Auto ROO Final Report at 27–28, para. 146.

include "elimination of the non-conformity or…[i]f possible, the provision of mutually acceptable compensation, or another remedy [that] the disputing Parties may agree [upon]."[26] Alternatively, if the United States rejects and ignores the Panel Report, then, per USMCA Article 31.19, Mexico and Canada may retaliate against the United States by "suspend[ing]…benefits of equivalent effect to the non-conformity" in the automotive sector or other sectors of the U.S. economy until the three governments agree on a resolution to the dispute.[27]

While the next steps remain to be seen, the United States previously signaled that it will issue new guidance on the USMCA automotive rules of origin and likely was awaiting this Panel decision first.[28] Additionally, an open issue is whether the ASR approval letters that the United States issued to various vehicle producers will remain in effect. These approvals afforded vehicle producers more time to meet the USMCA RVC requirements on the condition that the vehicle producers accept the U.S. interpretation regarding "roll-up" for core parts and the vehicle certification. Given the Panel's finding that this condition breached the Agreement, it remains uncertain whether the United States may reconsider those approvals during the 45-day period.

There are also multiple USMCA disputes underway among Canada, Mexico and the United States on issues ranging from dairy to energy. The United States may attempt to maintain leverage in those disputes by not immediately implementing the Panel's decision.

Toward the end of the first quarter of 2023, OEMs and suppliers are expecting critical U.S. government guidance regarding USMCA, the IRA and BABA. It is highly likely that there will be differing "originating" and "qualifying" standards under these separate agreements and legislative approaches. The United States may be able to achieve the result it was seeking in this USMCA dispute by using similar rationales in the IRA and BABA. Doing so, however, will create different, and potentially inconsistent, standards for automakers and suppliers seeking to design and implement sourcing and compliance programs.

Thompson Hine will continue to monitor and provide comprehensive analysis on these topics.

FOR MORE INFORMATION

For more information, please contact:

David M. Schwartz
Partner & Practice Group Leader, International Trade
202.263.4170
David.Schwartz@ThompsonHine.com

Dan Ujczo
Senior Counsel, International Trade
614.469.3319
Dan.Ujczo@ThompsonHine.com

Aaron C. Mandelbaum*
Law Clerk, International Trade
202.973.2737
Aaron.Mandelbaum@ThompsonHine.com
**Not admitted to the practice of law*

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[26] *See* USMCA Art. 31.18.
[27] *See* USMCA Art. 31.19.
[28] *See* Report to Congress on the Operation of the United States-Mexico-Canada Agreement with Respect to Trade in Automotive Goods issued by the Office of the United States Trade Representative ("USTR"), dated July 1, 2022, available at https://ustr.gov/sites/default/files/2022%20USMCA%20Autos%20Report%20to%20Congress.pdf (hereinafter "USTR USMCA Auto ROO Report") at 8 ("[US-]CBP plans to promulgate additional regulations to supplement the Uniform Regulations, including detailed USMCA guidance for the automotive industry, and provide the opportunity for public comments on those regulations. In the absence of those regulations, however, [US-]CBP has continued to enforce and ensure compliance with the USMCA rules of origin.").