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Cross-Border Movement of Goods: Developments in U.S.-Mexico Customs Procedures (A Panel Discussion)

Jimmie V. Reyna

Armando F. Beteta

Sue-Ann Linnemann

Lynn S. Preece

Adrian Vazquez Benitez

CROSS-BORDER MOVEMENT OF GOODS: DEVELOPMENTS IN U.S.-MEXICO CUSTOMS PROCEDURES

JIMMIE V. REYNA, ESQ.,* MODERATOR

PANEL

LIC. ARMANDO F. BETETA,**
SUE-ANN LINNEMANN,***
LYNN S. PREECE, ESQ.****
LIC. ADRIAN VAZQUEZ BENITEZ*****

REYNA: This panel is going to address cross-border movement of goods, and the focus will be on development of U.S.-Mexico customs procedures.[1] I will give a very brief overview of ground transportation issues, including trade and services, in order to provide a context for the discussions and also to open discussions that the Institute hopes to have with respect to international trade and services.

We are addressing customs procedures, which have all sorts of definitions, but are generally governmental measures applied to in-bound and out-bound cross-border movement of goods. Customs procedures are at the crux of a nation's sovereignty. One of the first and most sovereign rights exercised by countries in international trade is the protection of their borders, and exercise of the right to protect the borders - who comes in, what comes in, who goes out and what goes out.

But more than customs measures affect the cross-border movement of goods. Services and measures applied to trade and services also affect the cross-border movement of goods. Indeed, the production of many services results in the production of a good. For example, a CD is a trade in service that has resulted in a good, which is the hard, tangible aspect of a song. A book is also the tangible manifestation of a trade in service.

It is almost an axiom that the production of goods involves the provision of services. Practically every manufacturing process and every distribution of a good involves a trade in service. That being the case, any measure that impacts adversely or positively on a trade in service can also have an impact on a trade in good.

This is especially the case with respect to the cross-border movement of goods. For example, 75-80% of the value of U.S.-Mexico trade is delivered by truck.[2] So

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* Mr. Reyna is a partner at Williams, Mullen, Christian & Dobbins, in Washington, D.C. He received his B.A. from the University of Rochester, and his J.D. from University of New Mexico School of Law.

** Mr. Beteta was formerly Mexico's Representative at the NAFTA Center, Dallas, Texas. He currently serves as Foreign Legal Advisor to Strasburger & Price, L.L.P., in Dallas, Texas. He received his law degree from the Escuela Libre de Derecho in Mexico City, Mexico.

*** Ms. Linnemann is an International Trade Manager at the U.S. Customs Service Center in Dallas, Texas.

**** Ms. Preece is a partner with Baker & McKenzie in Chicago, Illinois. She received her L.L.B. from the University of Leeds in England and her J.D. from Loyola University in Chicago. She is a Council Member of the International Section of the ABA and an adjunct professor at John Marshall Law School.

***** Lic. Vazquez is a partner with Vazquez, Tercero y Asociados in Mexico City. He received his law degree from the Universidad Nacional Autónoma de Mexico, where he is now an Assistant Professor of Law.

1. This panel operated under a system of non-attribution. All comments made by representatives of the government solely reflect the opinions of the individuals, and are not official government statements.

2. Howard Chua-Eoan, *Burning up the road; NAFTA is about to unleash unsafe Mexican trucks that may become a nightmare for border states.* TIME, Dec. 11, 1995 (75% of U.S.-Mexico trade is carried by truck).

the production of goods is carried on the back of the provision of a service. In this case, then, a barrier to the provision of that service also has a result on the provision of the good. Any measure that impedes or restricts, or has a liberalization effect, on trucking services, has a corresponding effect on trade in goods.

We can see the effect of this with respect to two disputes relating to ground transportation issues. The NAFTA provides a timetable for removal of barriers to motor carriers, to investment in trucking and also to passenger bus service.[3] These trucking provisions of the NAFTA are explicit; that is, on December 18, 1995, the U.S. was to have provided Mexico access to all its border states. It was supposed to have done this with the delivery and back-haul of cargo. There were also some trade investment-related provisions that were supposed to have been enacted at that particular time as well, but I am going to focus only on the trucking measures.[4]

Also, by the year 2000, U.S. trucks are supposed to be able to conduct cross-border transportation to and from any point in Mexico and Mexican trucks are to be allowed to carry cargo cross-border to and from any point in the United States.[5]

Prior to the NAFTA going into effect, and in anticipation of the December 18 provision—the opening of the borders for trucking services—quite a bit of activity took place. It was all related to safety considerations, and driver training. Many of the states along the U.S.-Mexico border engaged in this type of activity. Right up to December 18, 1995, government officials from both countries were anticipating the opening of the borders. There was going to be a tremendous increase in trade as a result of opening the borders to trucking.

But the December 18 deadline came, and nothing happened. A Federal Register notice appeared, saying that amended ICC regulations permitted Mexican truckers to apply for a permit.[6] However, the United States also said it would suspend issuance of the permits, on the basis of safety and environmental considerations.

There was quite a bit of debate about this. Mexico stated that this was a unilateral action on behalf of the United States which violated not only the spirit but the letter of NAFTA.[7] But other considerations also became involved in the debate. The Teamsters' Union became extremely active in trying to impede the application of the December 18 deadline. A lawsuit was filed. Environmental groups joined in the lawsuit; safety groups were formed. For example, a group called Citizens for Reliable and Safe Highways (CRASH) was formed in the United States to raise concerns that allowing Mexican truckers on the U.S. highways was going to increase wrecks and injuries on the highways.[8]

Mexico was steadfast, however, in its position that the United States had violated an express provision within NAFTA. In fact, the failure of the United States to open up the border to trucking services was the first interrupted scheduled event

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3. North American Free Trade Agreement, drafted Aug. 12, 1992, revised Sept. 6, 1992, Can. Mex.U.S., 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA] at Annex 913.5 (a)(1)(iv).

4. *Id.* at Annex I, Schedule of Mexico.

5. *Id.* at §5(c).

6. Freight Operations by Mexican Motor Carriers—Implementation of North American Free Trade Agreement, 60 C.F.R. §201 (1995).

7. *See* Susana Hayward, *Mexicans offended by delay of broader NAFTA trucking*, Austin-American Statesman, Dec. 21, 1995; *Desprestigio duele*, El Norte, Dec. 7, 1995.

8. Curtis Howell, *Group aims to increase road safety: NAFTA truck traffic among chief concerns*, Dallas Morning News, Nov. 22, 1995.

under the NAFTA. As you know, in the NAFTA there are all sorts of scheduled events with timetables where certain things were to happen—the reduction of tariffs, for example—well, the trucking issue was the first time that a scheduled timetable was interrupted. So it became significant in that regard and a lot of collateral issues came into play.

This suspension is still in effect at this time, and the suspension has resulted or continued delay and congestion at the borders. Any time that there is a delay in the shipping of a good, it raises costs, and those costs can be viewed as trade impediments or restrictions. Mexico feels that the United States' action in this regard did just that. As a result, Mexico challenged the United States' failure to open up the borders to trucking under Chapter 20 of the NAFTA.[9]

Article 2004 of the NAFTA provides a mechanism by which a NAFTA member can challenge a provision within the agreement on the basis of the interpretation or application.[10] It involves three different phases. The first phase is consultation, which has a 30-day limit for the process. That consultation process went into effect in January, 1996, so Mexico immediately challenged the U.S. failure to open its border for trucking in 1996.[11] But the consultation process was extended and suspended on the basis that progress was being made.

The dispute was then taken to the Free Trade Commission, which is a commission set up under the NAFTA to look at issues that arise as a result of application of the agreement. On July 24, 1998, Mexico formally requested that the issue be taken up by the Free Trade Commission. That is where it is right now.[12]

If the issue is not resolved before the Free Trade Commission, then it will go to Panel review under Chapter 20, and if there is no resolution there, two things could happen. As a result of the Panel review, the U.S. will have to conform to the NAFTA, or it will have to pay some sort of compensation. This compensation is normally some sort of trade benefits arising under other parts of the agreement. That raises concern for producers of products that are considered to be import-sensitive products or products that are sitting and waiting for accelerated duty reduction. There is the sense that as a result of any adverse Panel decision affecting the United States, Mexico will seek compensation by not applying accelerated duty reduction for those particular products. That of course has a big implication for the producers of those products.

One of the reasons why this is important is that when you are looking at the strength and the weakness of a company, it is no longer enough just to look at its financial profile. Any company that produces and exports abroad or is involved in international trade will find its strength impacted by issues such as this. So any strategic corporate considerations given as to the strength or the viability of a company involved in international trade commerce should involve a full consideration of customs issues and trade-related issues. Right now there are over 30 regional trade arrangements in effect throughout the western hemisphere. Their

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9. *NAFTA Round-Up: Informal Talks Held on Border Opening for Trucks*, Latin American Law and Business Report, Apr. 30, 1996.

10. NAFTA, *supra* note 3, at Articles 2004-2008.

11. *World View NAFTA II: Mexico Wants Consultations on Truck-Rule Delay*, American Political Network Greenwire, December 20, 1995.

12. *Transportation: Mexico Seeks Arbitrational Panel*, Mexico Business Monthly, Nov. 1, 1998.

implications must be reviewed and considered, as well as the type of financing that would be available to any particular company.

The dispute has greater implications than that as well with respect to the operation of the NAFTA. We see this with what happened in the express industry. Prior to NAFTA, foreign companies that were providing express services were restricted in the size of the vehicles they could use. They could only use vehicles that had a capacity of 8,800 pounds of cargo or less. The express industry carries more than just packages; they specialize in shipments of all kinds and sizes. In fact, FedEx once, for example, shipped a live elephant.[13] They specialize in just-in-time delivery of cargo of any size and any weight. But in Mexico, prior to the NAFTA, they were limited to trucks carrying cargo 8,800 pounds or less. Nonetheless, despite this restriction and despite the fact that Mexican service companies did not have a similar restriction, UPS entered the Mexican market in 1989.

When the NAFTA went into force, Mexico had failed to reserve the trade and express delivery services; they did not include it as a reservation. As a result, it was open. National treaty obligations became immediately applicable to that industry. Instead of giving national treatment to companies like UPS, Mexico determined that it would suspend the issuance of permits to foreign delivery services to use trucks with a greater cargo capacity than 8,800 pounds. So the U.S. companies filed and have sought their own Chapter 20 resolution.[14] The consultations were requested and suspended as a result of talks that appeared to be promising, and it looked like finally there would be a resolution for the express industry.

But that has not occurred. In the interim Mexico redefined what a courier is. It issued draft implementing regulations that affect the provision of express delivery services in Mexico. Those provisions say that these companies cannot deliver packages of 10.5 ounces in weight or less. That means that companies like FedEx and UPS, but especially UPS, could not use a truck with a capacity of 8,800 pounds or more; also they were no longer allowed to deliver packages, because these services had now been consigned solely to the Mexican postal authorities under the monopoly reserved in the NAFTA.

So we have a situation now where Mexico has taken action that affects the trade in the service, an action that many feel is contrary to express provisions within the agreement, similar to what the United States did as well. This dispute has been suspended and Mexico has stated for quite some time that final regulations are about to come out and that the U.S. industry is going to be extremely happy with the final regulations. But in September of 1998, the Mexican government stated that they were not going to issue final regulations for the express industry until the United States resolves its trucking access problem.[15] So now we have a linkage between two really distinct disputes. Amazingly, both of these disputes arise under what some feel to be a violation of the express provision within the agreement.

We often hear talk that NAFTA is to enhance trade, but we also hear that anti-dumping actions violate the spirit. But the NAFTA allows actions like anti-

13. Arlene Vigoda, *Have Pachyderm, Will Travel*, U.S.A. Today, Feb. 9, 1995, at 1D.

14. Toby B Gooley, *NAFTA at five years: Uneven progress*, Traffic Management, Logistics Management & Distribution Report, Dec. 31, 1998, (citing UPS's filing of a formal complaint).

15. *Mexico Requests Creation of Arbitration Panel on the Access of Mexican Trucks into the U.S.*, U.S. Newswire, 1998 WL 13605744, Sep. 23, 1998.

dumping to be brought. They are not prohibited under the NAFTA.[16] Countries have nevertheless found ways to violate express provisions of the agreement. I think that has serious implications for the operation of the agreement. I would like to conclude by looking at four of the effects that this dispute has with respect to the agreement.

First of all, these disputes have the potential to undermine the NAFTA, to actually rise to the point where an unraveling can occur. We see that because the express industry issue has been linked to the trucking access issue, so we start at one point and now we get to another.

Under Chapter 9 of the agreement, on January 1, 1998, Mexico was supposed to have in place the provisions for recognition of conformity assessment bodies in the United States.[17] Conformity assessment bodies are the laboratories that do testing in order to assure that products are complying with applicable standards. When January 1, 1998, came, Mexico did not recognize U.S. conformity assessment bodies. In fact, Mexico stated that it believed that the January 1, 1998, deadline is the time they were supposed to start talking about it. The United States believes that deadline is a time they should have done something about it. So once again we have an interpretation of the agreement that goes back to this notion of the unwinding of the responsibility and obligation that the countries assumed under the agreement. As a result of the January 1, 1998, deadline, companies currently exporting to Mexico have to get the products tested in Mexico; they cannot get them tested in the United States. This is done at an immense cost, which is factored into the bottom line of the companies. This is another type of issue that needs to be considered any time that you are looking at the strength or the weakness of a particular company. What type of obligations does a company face in the marketing of its products in the foreign markets? This includes the application of standards. So a similar approach has been adopted.

These three different disputes have an underlying common basis: consumer protection, safety, health and environment. Under trade agreements, normally issues related to those factors are the type of areas that are typically allowed to be reserved, or for exemptions to be taken under them. The trucking issue has started out in such a way that a country faced with political opposition at home is able to argue that it has the underlying basis of consumer protection, and there is the potential for the country to say that it is not required to assume that obligation.

We also see that in other areas; for example, in Mexico's requirements to phase out export performance requirements. It falls off from 50% in the year 2002, and then the agreement states that Mexico will review the performance of this annex in consideration of its economic state at the time.[18] I think that type of language allows a country to back out of what looks to be a clear-cut obligation, and by the year 2002 there are to be no export performance requirements. However, the language in there gives the opportunity to back out of that obligation. Trucking issue incidents set the precedent and give a country the background by which to start seeking to evade its responsibilities.

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16. *See* NAFTA, *supra* note 3, at Article 1905.
17. *See id.* at Annex 908.2(1).
18. *Id.* at Annex 301.3, §B(4)(a) (exceptions to Article 309).

So if you have clients or your company is involved in the automotive industry that is facing these export requirements, that is something to consider. Indeed, will export requirements be phased out by that time?

The second point is that these types of disputes weaken the credibility of regional trade arrangements as the vehicle for economic development. The potential for a regional trade arrangement to really enhance economic development is one of perception by the public. This perception is based on investor confidence, which is based on predictability and security. With respect to public perception, disputes like this impede the adoption of "fast track" or additional trade negotiations. This type of dispute starts eroding investment confidence that an agreement like the NAFTA will indeed secure their investment, will indeed provide the type of mechanism and environment that they can predict what is going to happen to their investment in the future.

Third, these types of challenges diminish the economic value and the benefit of regional trade arrangements. We still have border congestion. Trucks still have to go to the Mexican border (and vice versa, Mexican goods have to come to the U.S. border), unload, carry drayage across the border, re-load, and send the goods along the way. All this raises the cost of commerce significantly. The promise the NAFTA held out to producers and to shippers of products to Mexico—that this cost would be diminished—has not been realized. It is this type of challenge, and this type of activity that diminishes the economic value and the benefit of regional trade agreements.

Finally, it has an adverse impact across the board. Today's panel is going to take a look at some of the issues involved in cross-border trade in goods. I made the comments just now with respect to trade in services because the governmental measures that I spoke about apply to a service. They do not apply to a good. Yet, the application of those measures to a service has a direct, adverse impact on the cross-border movement of goods.

Now we are going to take a look at some other types of procedures and governmental measures that apply to the cross-border movement, not measures designed to impact on services, but customs-related measures. And these customs-related measures are just as important for companies looking to invest in other countries or investors seeking to realize the strength or weakness of a potential investment vehicle.

We have a panel of some outstanding experts in their field and we are very fortunate to have them here today. Our first speaker is Armando F. Beteta, who is Mexico's representative at the NAFTA Center in Dallas, Texas.

BETETA: Thank you very much. Although I am also an attorney, I am one of the few government officials here. I am going to give you the Mexican perspective and particularly the customs perspective after NAFTA; what Mexico has done in the customs field in order to afford this integration into the North American region.

Before I deal with the customs issues specifically, I would like to let you know that even before NAFTA, at the end of the 1980s and the beginning of the 1990s, Mexico changed its economic policy by opening its economy and changing and modifying its legislation. One of the important changes happened, for example, in the foreign investment field. Before 1991, Mexico had a foreign investment law which was restrictive in the sense that it prohibited everything except what it

specifically allowed.[19] After 1991, that law changed radically in the sense that it now allows almost everything regarding foreign investment except what it specifically prohibits.[20] So it was a complete change in that field.

Another important area is intellectual property rights.[21] In industrial property rights, Mexico modified its legislation before NAFTA and issued legislation that is similar and even better in many cases, than the U.S. and Canadian legislation in that field. Intellectual property legislation, on the other hand, was also modified, but that was after NAFTA. Mexico has undergone many very positive changes, and we are starting to see the benefits.

In Mexican customs we also started to modify our procedures to balance those two very important and different issues that Mexican customs has to deal with: trade and enforcement. That balance is a difficult task, which needs to be addressed. With the free trade agreements that Mexico has dealt with lately, the role of Mexican customs in the revenue field has diminished significantly. We are not looking at enforcement in the sense of getting more taxes because they are being eliminated. The more trade agreements that we get involved with will of course increase the tendency to diminish the revenue role of Mexican customs. But what did we do at the beginning of the 1990s in order to facilitate trade?

First of all, you already know that in order to import a good into Mexico, one of the basics is that you need to hire a Mexican customs broker (*agente aduanal*) or an in-house broker (*apoderado aduanal*).[22] Of course, there are some exceptions to that rule, but the customs broker is solely responsible to the importer and is going to be facing the government or responding to any rights and obligations that the importer might have before the government.

The broker usually gets all the paperwork ready and files what we call the *pedimento de importación* or customs requisition, which is the basic document that will contain all the information regarding importation. It is very important to realize that as a general rule Mexican taxes and countervailing duties must be paid prior to importation. In other words, in Mexico, there is usually no bond placed for importing except in a very specific situation, which is a different case, whenever you are undervaluing your product. But the rule is that duties must be paid prior to importation. Once the broker has all of the paperwork ready and has submitted this information to Customs via an automated system, the Customs computer sends information back to the broker, letting him know if there is anything missing. This is very important because the idea is that when the truck reaches the border, most things must be in place and duties must have been paid.

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19. *Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera*, D.O., Mar. 9, 1973.

20. *Ley de Inversión Extranjera*, Art. 4, D.O., Dec. 27, 1993 ("*La inversión extranjera podrá participar en cualquier proporción en el capital social de sociedades mexicanas, adquirir activos fijos, ingresar a nuevos campos de actividad económica o fabricar nuevas lineas de productos, abrir y operar establecimientos, y ampliar o relocalizar los ya existentes, salvo por lo dispuesto en esta Ley.*" Foreign investors can participate in any proportion in the capital of Mexican corporations, acquire fixed assets, forge into new areas of economic activity or fabricate new lines of products, open and operate establishments, and amplify or relocate those already existing, except for what is prohibited in this Law.).

21. In Mexico, intellectual property deals specifically with copyrights. Industrial property rights address patents and trademarks, and are applicable here.

22. *Ley Aduanera*, Tít. VII, Cap. Unico, Secc. 2, Art. 168-173, D.O., Dec. 15, 1995.

So what happens when that truck actually reaches the border? Let us assume that it is coming from the United States into Mexico. The truck submits the *pedimento* and it faces what we call the random selection mechanism (signal lights), which is something you might already have experienced as a passenger. However, a difference between importing cargo and importing as a passenger is the number of signal lights each faces. On cargo there might be two signal lights or random selection mechanisms, while for a passenger there is only one. This random selection mechanism gives some transparency to the importation process. It does not allow an individual inspector to stop you because he does not like you, for example. This was established to eliminate corruption because the computer will automatically randomly assign you a green light or a red light. If you get a green light, the goods are released, and there is no inspection. However, the duties have already been paid and all documentation has been submitted. If you get a red light, the first inspection would take place. Approximately 10% are red lights. Of course, this also helps us simplify the import procedure. If we had to check every single truck, it would be impossible.

The Tax Administration Service of Mexico, the SAT, in particular the Customs inspectors, conducts the first inspection. After this first inspection, there is the second signal light, and again, if you get a green light you would not get inspected, but if you get a red light, there would be a second inspection. The chances of getting a red light here are around 1% of that 10%. You may say that this is a barrier to trade, and what is important about this second inspection? The second inspection is important because it gives another objective point of view. A private corporation composed of *dictaminadores aduaneros* conducts it.[23] The important thing about this procedure is that it also gives you a second point of view that is not the governmental point of view.

Let us look at the specifics of importing a NAFTA good into Mexico. As you are already aware, in order to import a good that qualifies for NAFTA, according to the NAFTA rules of origin, the basic requirement is that you have to submit a certificate of origin.[24] Of course, this is a trilateral requirement; the certificate of origin is a trilateral form that contains exact information in the three different languages.

What is very important about this certificate of origin is that the exporter provides it.[25] The exporter signs it; it does not require any other certification; it is a rather simple document. But though it is simple, we always face a lot of problems with it. There are a lot of people who think that it is so simple that anyone can fill it out without due diligence. It is very important to fill this certificate out correctly because the certificate gives the importer in the other NAFTA country the opportunity to waive duties. Looking at it from the other perspective, if you submit a certificate of origin that is not correct, this could translate into tax evasion. So it is a very important document even though it is not difficult to fill out.

What do you need to do when you are importing a NAFTA good into Mexico? The first thing is submit the *pedimento* or import requisition with the written

23. *Id.* at Tit. VII, Cap. Unico, Secc. 3, Art. 173-175, D.O., Dec. 15, 1995.
24. NAFTA, *supra* note 3, at Art. 501.
25. *Id.* at Art. 501(3)(a).

declaration stating that the good qualifies as originating, of course. Such a declaration should include the country of origin code assigned by NAFTA marking regulations in order to be able to determine the applicable NAFTA rate. Why is this important? Because even though the good might qualify for NAFTA and therefore qualify for a preferential duty rate, a preferential duty rate does not mean immediately no duties. It means there is a lower rate than the Most Favored Nation rate, basically. Thus, even though your product qualifies for NAFTA, because it is made in Canada for example, it might have a different preferential rate than that which applies to U.S-originating goods. So it is very important also to mark the good as Canadian or U.S.

Next, the importer should possess the original NAFTA certificate of origin at the time the *pedimento* is submitted, and of course a copy of the certificate is allowed whenever several importers are conducting an importation of the same NAFTA good. Also you need to turn a copy of the certificate in to the Mexican customs broker, and upon request of the Mexican authority, turn in the original, or when applicable, a copy of the certificate. It is important to point out that usually the certificate of origin, even though it should be in possession of the importer at the time the *pedimento* is submitted, is not questioned at that point. It is not the Mexican Customs Administration that is going to be examining that certificate. The authority examining the authenticity of the certificate is part of the Tax Administration Service, as Customs is, but it is the International Auditing Central Administration (*Administración Central de Auditoria Internacional del SAT*). When it is believed that a certificate of origin contains incorrect information, a corrected *pedimento* should be submitted and the omitted duties must be paid in order to avoid any penalties.

One exception to this rule is an agricultural product using preference criteria "F." I do not think we should get involved with this at this point, but it is a very specific situation where the certificate is really handed in at the point of entry.

There are specific situations that, although they are not precisely NAFTA situations, are involved in this procedure itself. Whenever you are importing into Mexico a good which contains sugar—chocolates, candy, and so on—you need to submit another certificate that will show that you are not benefiting from the sugar re-export program applicable in the United States.[26] I do not know the exact reason for this, but it means that this program is not compatible with NAFTA.

As you might be aware, in order to import a product into Mexico, sometimes you will be asked to submit a NAFTA certificate of origin. Other times you might need to submit a certificate of eligibility. Other times you might need to submit an Annex III certificate to avoid anti-dumping duties. But the certificate of eligibility is a separate certificate which is not the NAFTA certificate because you are not dealing with NAFTA-originating products, you are dealing with a textile that is being transformed in North America in a substantial way. But due to the NAFTA rules of origin, it does not qualify for NAFTA because NAFTA is very strict with textiles. It usually requires that the yarn or the fiber should come from North America in order to qualify for NAFTA.

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26. *Id.* at Annex 703.2, §A(21).

Being so strict in that sense, the NAFTA people designing the agreement decided to give an option for this, as a lot of transformation of textiles is taking place in *maquiladoras* and everywhere around the United States, Canada and Mexico. They gave an option called tariff preferential levels. It actually allows you to claim a preferential duty rate even though you do not have a NAFTA certificate of origin or a NAFTA-originating good. But it will allow you to claim that rate as long as you get a certificate of eligibility from the authority. This certificate of eligibility is usually subject to a specific quota, or *cupo*, as we call it in Mexico.

These are basically the requirements you have to fulfill in order to import a NAFTA product into Mexico.

I would like to discuss the topic of *maquiladoras* a little bit because of the importance it has in Mexico in particular and the importance it is going to attain after 2001. The 303 NAFTA provision does not mean that *maquilas* are going to be disappearing.[27] It basically promotes sourcing of raw material from North America in products which are being assembled in North America. And of course by "North America," I do not mean only the United States, I mean Mexico, the U.S. and Canada.

So what does this Article state? This Article is already in force between the U.S. and Canada.[28] Between Mexico and the U.S. and between Mexico and Canada, it will become effective in the year 2001.[29] This Article states that when a good is imported into the territory of a party pursuant to a duty deferral program and is subsequently exported to the territory of another party, the party from whose territory the good is exported has to do two things, and this is exactly what you need to do - you shall assess the duties as if the exported good had been withdrawn for domestic consumption. In other words, it would mean that your temporary importation that applies to the *Maquila*-PITEX program and other similar programs, is a temporary importation that will become a definite importation even though your product is leaving Mexico. For NAFTA purposes if it is going to Canada or the U.S., it is going to be considered as imported into Mexico.

Second, there might be a reduction of customs duties in an amount that does not exceed the lesser of the total amount of customs duties paid or owed on the good on importation into its territory and the total amount of customs duties paid to another party on the good that has been subsequently exported to the territory of that other party. What does that mean in English? I will give you an example. Let us say an importer from Mexico brings material from Germany in order to produce a photocopier, which is going to be exported to Canada. In this case, the importer will be able to reduce or waive the lowest of the duties incurred when importing the raw material from Germany, and that which applies to the final product into Canada.

So you are comparing two duties—one that applies to the raw material and one that applies to the NAFTA product. Let us assume for this example that your product qualifies for NAFTA because it is a Mexican product. So we have for example the material imported from Germany—and we will put it in dollars,

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27. *Id.* at Art. 303.
28. *Id.* at Annex 303.7§§A, C.
29. NAFTA, *supra* note 3, at Annex 303.7, §B.

although it should be paid in pesos of course—you would consider paying $100 for importing that raw material into Mexico, as if you were importing it definitely, even though you are importing it into a *maquiladora* temporarily. Then you produce a photocopier, which is a Mexican photocopier. We assume that photocopier is complying with the NAFTA rule of origin and you export that photocopier to Canada. Because it is a Mexican photocopier, the duty is $20, a preferential duty rate, not an exemption of duties. So in this case, the temporary importer should pay Mexico $80 when the NAFTA product is exported to the NAFTA region, because it received a reduction of $20. You reduce the higher duty of the component by the lower duty, and the outcome would be $80.

But what is going to happen in the year 2001? Probably, a Mexican photocopier going into Canada will be duty-free. So what will you be waiving? Nothing. You will have to pay the full $100 in Mexico.

Back to the Mexican customs procedures, one of the important changes that we went through in 1995 was that we modified our Mexican customs law.[30] Among other things, we provided more importance to a figure called the *apoderado aduanal* or in-house broker.[31] This in-house broker is an alternative to using your regular broker. The broker is someone you would hire to conduct the importing, to represent you as an importer, be solely responsible to the Government with you. He will, of course, charge you for his services. For businesses doing a lot of imports into Mexico, and for anyone who would be interested, the Government established this figure. It could be any person assigned by another individual or corporation to import and export merchandise on his behalf only after having obtained authorization from the Tax Administration Service of Mexico. The customs representative shall conduct business involving only one customs port and represent only one person, who shall be responsible for the representative's actions. So this person is your employee and the actual corporation is going to be responsible for everything he does. This is an option that is given. Some businesses have adopted this option, others have not.

We also are enforcing the figure of the *pedimento consolidado*.[32] The *pedimento consolidado* is the exception to submitting the *pedimento* before importation. It applies on exports from Mexico to any other country and on temporary importations used by *maquiladoras* and programs similar to *maquilas*. It allows you to import your merchandise using your regular invoices and submitting the *pedimento* one week after the actual importation takes place.

Last but not least is another important provision related to NAFTA, and also to intellectual property rights. This provision is the customs provision that implements Article 1718 of the NAFTA Agreement.[33] That Article obliges the three nations to enforce intellectual property rights at the border. In the case of Mexico this was a difficult situation because Customs is part of the Tax Administration Service. We have no jurisdiction over intellectual property or industrial property rights. The *Secretaria de Comercio y Fomento Industrial* (SECOFI) has jurisdiction over

30. *Ley Aduanera*, *supra* note 22.
31. *Id.* at Tít. VII, Cap. Unico, Secc. 3.
32. *Id.* at Tít. II, Cap. III, Art. 37.
33. NAFTA, *supra* note 3, at Article 1718.

industrial property rights, while the Ministry of Education deals with intellectual property.

So we created a hybrid regulation which establishes that the Ministry of Finance and Public Credit shall suspend the release of foreign goods into the commerce of Mexico when a previous resolution by the presiding Mexican authority in intellectual property rights or industrial property rights has been issued.[34] These goods are then placed in the custody of the proper Mexican authority after having been detained within the applicable tax precinct. So we would require a notification from the proper authority in order to seize goods which infringed on intellectual property rights.

My office, the NAFTA Center, is a trinational office established in 1995. This is the first joint venture between U.S. and Mexican Customs where we are working together in the same place. The NAFTA Center is the friendly side of Customs. We give free advice to exporters, producers and importers in North America regarding Customs procedures and NAFTA procedures, specifically Chapters 3, 4 and 5 of the Agreement.

The office is composed of Mexican and U.S. officials from Customs and we are all bilingual. We handle around 250 inquiries per week from all over North America—Canada, Mexico and the U.S. We have what we call the automated fax information line, a computer that contains over 600 documents covering a variety of NAFTA-related topics. It is available 24 hours a day, 7 days a week at no cost, except what the call would cost you.[35]

I would also like to state that we already have our new trilateral web page, which is called the NAFTA Customs Website, or *Página Aduanera del TLCAN*,[36] and we have a lot of information on Customs procedures under NAFTA in the three countries and have the same information in Spanish, English and French. Our opinions are advisory only; we do not issue any binding rulings, but we would direct you to the proper authority if you need a binding ruling.

Thank you very much.

REYNA: Our next speaker is a representative from the U.S. Government. Her name is Sue-Ann Linneman. She is the International Trade Manager, U.S. Customs Service at the Office of Strategic Trade in Dallas, Texas.

LINNEMAN: Thank you very much.

First of all, Mr. Beteta made a comment about governments using customs to protect their borders and to earn money, and the U.S. Customs is certainly a prime example of that. We were established as the very first agency of the federal government right after the Revolutionary War, so we have a long and proud history of protecting the borders and making money for the U.S. government. Obviously we do not make the most money any more, as we used to, but we still bring in $20 billion a year. The good news is that we do bring in the money. The bad news is that we are a barrier to trade, which means a barrier to you and your client. Mr. Reyna talked about just-in-time inventory. Truthfully, every time I say that I get

34. *Ley Aduanera*, *supra* note 22, at Tít. VI, Cap. Unico, Art. 148.
35. In order to access this information line, dial (972)574-1582.
36. Available at < www.nafta-customs.org.>

chills up my spine because just-in-time inventory and government regulatory agencies really are non-compatible terms.

We as an agency are looking at about 3-5% of the goods coming across the border into the United States, which means that 95-97% of your goods go through without being looked at. That other 3-5% is going to be a problem. If that is the shipment that you need to be there or the line is going to be down, the line will be down because we have a responsibility to the American public and to Congress, which takes a very strong oversight of our agency.

Attached to NAFTA was another bill called the Customs Modernization Act.[37] It was a bill drawn up by U.S. Customs, Congress, and international trade organizations. So it was an unusual bill. A lot of people liked it; a lot of them did not, so they attached it to NAFTA because they thought "NAFTA will never pass," so this bill will never go anywhere. And, lo and behold, NAFTA passed and the Modernization Act passed with it.

It had a couple of interesting aspects to it. One was that it allowed Customs to automate.[38] Prior to that the law said that thou shalt present a piece of paper with original signature and tons of data to Customs, and that had been the law for 200 years. In the early 80s we began a pilot program of allowing electronic transmission of data to us, but it was not legal. So when NAFTA passed and the Modernization Act passed, it legalized what we were doing as practice of accepting electronic commerce. We are always playing catch-up to industries because you guys are always on the cutting edge of doing whatever it is electronically.

Since the late 1980s we have developed a tremendous database of information on goods entering the U.S., the people who enter them, the people who make those goods, the people that ship them into the U.S., what the goods are, what they cost, this whole database.

My office, the Office of Strategic Trade, was developed when the Modernization Act passed, which also allowed Customs to reorganize. We did not have an Office of Strategic Trade up until that point and Customs very much operated on a port-by-port basis, which was fine if you were an importer and came across at one port in the United States. You dealt with the same people all the time. You had no conflict. However, there are 304 ports of entry, and very few companies use just one port. So the odds were that you got one way of looking at your goods at one port, and the other port had another way of looking at your goods.

Maybe if you had a very simple article such as candy, you might get the same type of information from every port of entry. But something as simple as a glass could cause conflict because of what is the make-up of the glass, how much do you know about it, how much did you tell us? Industry is far ahead of us in making things that our tariffs cannot classify or put in a nice little column somewhere. So the odds were that you would get a different answer at different ports of entry. Strategic Trade was designed with that as at least one of our goals. We are a group of people—there are five Strategic Trade Offices across the country—and we look

37. North American Free Trade Agreement Implementation Act, Pub. L. No. 103-182, 107 Stat. 2057 (1993), at Title VI ("Customs Modernization Act").

38. Customs Modernization Act, *supra* note 37, at §631, National Customs Automation Program (amending 19 U.S.C. §1411).

at imports and industries on a national and global basis, not so much port-by-port or transaction by transaction.

The Dallas office where I am located right now is looking north—up until October 1, 1998, we purely looked at southern border NAFTA. We realized that is not enough work for us. NAFTA is going along pretty smoothly, in spite of other things you have heard, and so we have expanded a little bit and picked up communications, which is going to be a real challenge; agriculture, which is a nice hot political topic; and NAFTA southern and northern border. So we are looking at those three industries.

I have been spending a lot of time in meetings lately. In the communications meeting, we are doing a lot of work with industry. Our division works very closely with U.S. industry and tries to be responsive to U.S. industry. In the communications field itself there is a group of communications companies that want us to go out and look at the import of copper-clad laminate into the U.S. One, they say, "More is coming in than we can possibly use to make integrated circuits, and what the heck else is it used for? Candy wrappers?" We do not know. They want us to go out and look at it and find out what is wrong.

The second thing is the values are way out of whack; the value should be maybe $5-100 per square meter and right now the range is from 1¢ to $22,000 per square meter. Something is wrong. That is what my office is designed to look at. We are going to work with the trade, look at the goods coming in, look at the value. And we know right away there is a big problem because copper laminate comes in sheets and rolls, and yet the tariff requires that it be reported in square meters. Just doing a sampling of various brokerage offices, nobody knows how to convert to square meters, so we know right off that the measures are wrong and therefore the values are wrong because they cannot correlate. So the industry's concerns may be alleviated just by doing some informed compliance training across the nation in how to do this. That is the kind of thing that my division is going to do.

Agriculture is very interesting too, because it is a really sensitive topic. There was a big strawberry issue last year, and lots of concern that tainted strawberries were coming across the border.[39] It actually turned out the problems probably occurred after the goods got in the U.S., but it was a very hot political issue.

There is going to be a nationwide issue on tainted foods which our office will be at the core of, working also with Food & Drug and the United States Department of Agriculture (USDA). If anyone here represents anyone who does foodstuffs of any kind, fresh, prepared or anything, I can tell you there are going to be challenges, and purely because this is a hot political issue right now. We have a new commissioner and he is getting pressure from somewhere to be looking at tainted foods. Now, to test for tainted foods, sampling has to be done. If sampling is done by Food & Drug, that shipment has to go sit somewhere until the laboratory testing on those foods is completed and the goods are determined to be safe and ready to go into the system. Again, just-in-time inventories - if you are advertising saying you have these goods on the shelves tomorrow, that will not happen if that shipment is sampled in this program. So those are the kinds of things that are going on with

39. Kevin Hall, *Hepatitis Scare Raises Inspection Questions; Study Says USDA Buried Under Produce Imports from Mexico*, Journal of Commerce, Apr. 4, 1997 at 1A.

the Office of Strategic Trade: very industry-driven, and nationwide—global actually—in perspective.

Electronically we have a big database and it is very simple for my electronic wizards to go in and sort the database and come up and say, "Okay, where is this copper-clad laminate?" or "Okay, where are these strawberries coming in?" or any of those things.

We have another database that is not quite so large on NAFTA. The enforcement activity that goes on for NAFTA is determining whether that certificate of eligibility actually means more than the piece of paper it is printed on. What happens is that our joint verification teams go to the exporter's premises to see that the claim made on that certificate is valid. These joint teams have an auditor, an import specialist and possibly someone from my office to go out and make that visit. That is the U.S. team. Mexico and Canada have their own teams that go out and look at that. This has been happening for the last couple of years and every time they come back with a result from one of those visits, it has been put into the database.

The law says that if you fail a verification three times for the same commodity, same exporter, we can stop you from getting NAFTA treatment for that good. We are now going and looking at whether it has happened at various ports that did not talk to each other. Secondly, we look at whether the same company has NAFTA verifications for different products and fails them for different products. In that case, they have not been shut down yet, but maybe we need to go in and do a full audit of that company to look at what their internal procedures are. A lot of enforcement activity is going on.

Since 1993 when NAFTA and the Modernization Act were passed, Customs became kinder, gentler, friendlier; we realized we had customers, things we did not accept before because we were an enforcement agency. We give speeches and tell companies what their responsibilities are. It is called reasonable care. Companies have a responsibility to take reasonable care to make sure that they fulfill their responsibilities as far as U.S. Customs is concerned. We have been doing this for three years now, and the theory inside the agency is that the time for reasonable care informed compliance outreach is winding down, and the time for what we call enforced compliance is now coming to the top. Companies, especially the largest companies in the country, have had a lot of intensive scrutiny from Customs, what we call CAT audits, or compliance assessment audits. We have put out a lot of publications on commodities and how to classify them, reasonable care, lots of different things like that.

And now we are moving into this other enforcement mode, which I will tell you makes our criminal investigators and our inspectors very happy. They really always thought they were enforcement agents and they relish this role.

If companies who have had these compliance assessments come out at less than 95% compliant, which is very, very difficult to do, a couple of things happen; we put on self-improvement plans, we work with them at classifying several things at a time. Some of those companies bent over backwards, and I am truly in awe of a couple companies that took the steps they did so that they could move to what we call the "best bucket." The benefit of being in the best bucket is that we look at you even less than the 3%; we stop your shipments for exams less than that 3%.

If you are less than 95% compliant, you refuse to do a self-improvement plan, or you did a plan and just blew it off, or you kicked everybody out of your office (a

few of those things have happened) we have a really good tool. We can stop all of your shipments when they come across the border. We have not gone so far as doing all of the shipments for anyone yet, but the percentage is being programmed into the computer as I speak. That is a pretty good punishment. If that does not work, we have some pretty significant penalty activities, dollar amounts, that can take place. You get to see a lot more of this than you ever wanted to do. So that is where it can go.

Record keeping is a very important part of all of this, and auditors. Auditors do not necessarily look at your stuff; they look at your records. The Modernization Act put a very strong record-keeping requirement in there.[40] Customs said, "We want the records available for our scrutiny and if you do not have them, we think it should be a $25,000 penalty," and the trade said, "Oh, my gosh, we cannot live with that; it should be much less than that - $5,000 penalty." And Congress said, "This is extremely important; we are taking this agency from an on-the-spot and transaction-by-transaction basis to an audit basis. The penalty is $100,000 per violation."[41] Nobody has gotten that yet, but there are some very close.

It is extremely important to keep those records. If that joint verification team comes out to see your records and you do not have them, first of all, they immediately deny the NAFTA claim for that shipment and you receive a bill for anything that came through on that certificate of origin. Now, for Mexico generally the shipment covers one shipment, but for the U.S. it can cover a whole year's worth of shipments. You could get the bill for that whole year, plus the record-keeping penalty on top of that. I just cannot stress how important it is for the legal community to understand what the enforcement activities are.

Recently Customs found a company who was told to do something in one city and did not like what they were told and so they started importing through another port; looking at the computer that became pretty evident and the Customs offices started working together and recently issued a $184 million penalty against this company, a major company. This company also sells to other good-sized companies in the U.S. and headquarters attorneys have looked at it saying that, "Reasonable care does not mean that if you are buying from an experienced importer that you accept their word that what they qualify for is correct. You should ask for the back-up documentation that supports that." So not only is the one company going to get the big penalty, but the other ancillary companies are now having to do some real backing up, giving tenders to Customs because they are accepting the responsibility - some are accepting, some are going to argue - but this is a pretty major decision of the Customs Service.

My point is that we are having coordinated Customs action. Port shopping is no longer a viable alternative; you have the ports themselves looking at the database, you have Strategic Trade looking at the database. Enforcement activities are going to be the rule for the next couple of years to answer to Congress that we are enforcing NAFTA, which is still a highly political issue. There are a lot of non-supporters of NAFTA out there. The Customs response is that we are enforcing it, making sure that those who are claiming it qualify for it.

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40. Customs Modernization Act, *supra* note 37 at §614; (amending 19 U.S.C. §1508).
41. *Id.* at §615(g)(2)(A), (amending 19 U.S.C. §1509).

I know that all three countries are not doing the same thing across the board, and we need to be working together more. We have what we call the NAFTA Targeting Committee and there are people on that who sit on the trinational committee, and I am going to work with them to talk about not having all three countries go to the same company and look at the same certificate of origin for the same merchandise, one right after the other.

The drug war is escalating and the war on drugs is the worst thing that can happen to trade because it means more examinations. They are putting x-ray vans at every place on the border. Just look at Laredo, Texas. A couple of years ago Laredo was getting 4,000 trucks a day, a huge amount. The back-up is hours. So they built a new bridge. Nobody went there for a while, but now they are going there, and now there are 3,000 trucks a day at Columbia and 3,000 at downtown Laredo. They are building a new bridge and what is going to happen? You guys are going to send more trucks through Laredo and fill that up too. They are looking at additional bridges farther east in Texas. They just opened another one in California, trying to deal with this crush of trade. But the trade is growing faster than the facilities can handle it. If the back-ups are slow now, with the increased drug enforcement, they will get slower.

Just last week Customs and Immigration joined together to do joint enforcement on the border. Hopefully that will be good for trade because if they can use all the manpower capability that they have on the border to do drug enforcement and not do such duplication of efforts, maybe it will go much more quickly. We can only hope so. Again, we are always playing catch-up with the drug war and we have to go where it goes. One day your goods may get through the border in a hour because it is a pretty fast-moving border but if the next day they get a big seizure at that port, I can guarantee that it is going to slow down.

I wanted to mention a couple of other things on the Modernization Act. There is remote location filing, which is a really great thing to come out of electronics.[42] If you are a major company, you can file all of your entries from a single point in the U.S., so you can have one location for your record keeping and your record generation. It just has to be filed at whatever port the goods arrived at first. So you do not have to have someone to generate your entries at each and every port.

The other nice thing about remote location filing is that if a non-drug-related exam is generated, you can choose which port you want the exam to take place at. So if you are in Santa Fe and so is your office, and your goods come in at L.A., Houston, and Miami, you can have them all brought here for exam where you have your own people who can assist the Customs people so we don't ruin your stuff. I hear that a lot in electronics, "You guys opened our box and now it is ruined because the static electricity ruined all the parts." If you have sensitive equipment, especially, that is a really neat thing you can have.

Another one that came up is reconciliation. Unlike remote filing, which is a voluntary program, reconciliation has now been mandated.[43] If you are a company that does not know all of your costs until the end of your accounting period, you routinely gave Customs a reconciliation at the end of your period and we received

42. *Id.* at §631, Remote Location Filing (amending 19 U.S.C §1414).
43. *Id.* at §637(b)(amending 19 U.S.C. §1484(b)).

them at whatever the end of your accounting period was. Starting October 1, 1998, the reconciliation program says that you will not be doing that the way you did paper document by paper document, but you will tag electronically each entry that you make, saying that you do not have all the information and that within 15 months of the first entry you will present a reconciliation entry to Customs to update all of that. The good part of that is that you can tag value as an issue and everything else will liquidate on the entry. The bad news is that you just have this one format. Customs is not going to hold all your entries and then liquidate it all on one and you will get one bill at the end of the period. You will get one bill, but it will be on your reconciliation entry.

Many companies do not have accounting periods that begin October 1. They did get grandfathered so that whenever your accounting period ends now, the very next day will be the start of your reconciliation period. So that is a new one that came out.

We also have a program called Account Management where someone in Customs works specifically with your company. The nice thing is that they become a liaison between your company and Customs so that you do not have to talk to 25 different ports if you import through 25 different ports; you can have one point of contact.

We were talking about how our auditors do not always treat everybody the same. And not all auditors are created equal either. But we do have a cadre of computer specialists who are very good at looking at computer stuff. Then we have other people who really like paper. We are all individuals and everybody looks at things slightly differently. Some of our auditors are like our agents and inspectors who love to write penalties or do the enforcement activity. It really behooves you to note if you are working with a company that does not consider Customs on the same level that they do their IRS responsibilities, they are just setting themselves up for problems if they are working globally.

Thank you.

REYNA: It is amazing how much Customs authorities now provide. A lot of that is as a result of the NAFTA, but you can see from Mr. Beteta's and Ms. Linnemann's presentations that the respective governments have a wealth of information that is available to people. Ms. Linnemann mentioned the informed compliance requirements under the Customs Modernization Act, and the reasonable care standard. Well, one of the aspects of the reasonable care standard is that you obtain competent advice in your transactions. For that reason, we have two representatives from the private sector, two customs attorneys who are pre-eminent in their field, to give us the perspective of the private sector and to share with us what this competent advice consists of. Our next speaker is Lynn Preece. She has been with us before and presented an excellent paper then.[44] We welcome you back, Lynn.

PREECE: Thank you, Jimmie. Hello, everybody. I have a few stories, if you like, that I wanted to impart to you based on my own personal experiences with NAFTA, and also to give some counterpoint to what Sue-Ann Linnemann has said in terms of Custom's side of the fence.

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44. Lynn S. Baker (Preece), *The Problems and Prospects of a North American Free Trade Agreement: Customs and Other Border Enforcement Issues*, 1 U.S.-Mex. L. J. 115 (1993).

The first thing that I want to discuss is the Certificate of Origin under the NAFTA. As we all know, the Certificate of Origin is really the crux, the cornerstone of any NAFTA claim. I wholeheartedly concur with Ms. Linnemann here; people do not pay enough attention to it. You would be amazed at how many are actually signed by Customer Service clerks. Not to denigrate them, but they would not know what NAFTA was if it fell on their heads. All they know is the customer needs a form signed, so they sign it and send it back. They are Customer Service, they are there to support the customer. What the customer wants, the customer gets. I am sure many other people have also seen this.

The Certificate of Origin is a very simple form and that makes it very deceptive because the NAFTA Rules of Origin can be horribly complicated. When you first start talking to someone about the NAFTA rules, they say, "Why don't you just send me the rules?" Then you explain to them, "How many trees to you want me to kill in the process? I will send you the rule for your product, and that may be six or seven pages long." I always stress to they should concentrate on the rule in their industry. Depending on which industry you are in, it can be very simple.

For example, people in the home appliance industry and their trade association in the United States got together and decided that they would suggest to their trade representative negotiating the NAFTA that if one central part of the product (for example, the compressor in a refrigerator) is locally made, the most important part is made in a NAFTA country, we do not care from where all the other bits came.[45]

At the other extreme we have the automotive industry, which made this into the most mind-boggling exercise you have ever seen. If anybody has actually ever tried to work through the rule of origin for example on heavy goods vehicles,[46] it makes you want to cry, quite frankly. A lot of companies do not understand that. As lawyers, I think we have the obligation to bring the importance of this to the right people within the company. We find that very often the customs function is often put in an inappropriate place within the company, such as transportation, which is automatically a dichotomy because the people in transportation only want to get the goods out the door. People who are doing the customs work, which is mainly documentation, do not want the goods out the door until the documents are right. You have friction right there. Or it could be anywhere, purchasing, tax; I have seen it in various other places. We find typically that it is too low within the organization. Certainly when you start talking to people and say, "Well, who is responsible for your tax work in this company? How many people have you got doing your tax work?" the lightbulb starts to go on. The point here is that the Certificate of Origin is a very, very important document because if the Certificate of Origin is not right, the NAFTA claim is not right and everything else falls along the line. Do you remember the nursery rhyme "For want of a nail a shoe was lost," and from there on until we lost the country? It is the same thing. I heard from a U.S. Customs officer that at one point they believed that over 50% of the NAFTA Certificates were incorrect. That is staggering. It is only a one-page form. How

45. *See* The North American Free Trade Implementation Act, Ch. 4, §A, 7, *available in* 1993 WL561138 (N.A.F.T.A.), at *3; *Position with Regard to the North American Free Trade Agreement: Report of the Industry Sector Advisory Committee for Trade in Consumer Goods for the North American Free Trade Agreement, available in* 1992 WL 721894, at *8.

46. *Id.* at Ch. 4, §A, 8, at *3.

many ways is it possible to mess it up? There are a lot. There is not enough care and attention given to the Certificates of Origin.

As many of you know, there are four different criteria that you claim, depending on whether it is something that has been manufactured, because it meets the rule through regional content or whatever.

The first one is Criteria A, which is typically for goods that come out of the ground or are grown; natural goods. A rule of thumb, at least I have been told on the northern border, is if you put Criteria A down you are going to get a second look because there is not that much that fits under Criteria A. Manufactured goods do not fit under it, without going into the rule. People read it and say, "Oh, yes, it is made in the United States; check Box A." They do not even go to B, C and D or read the instructions on the back. So that is how the NAFTA Certificate is filled in.

I have a major disagreement myself and it is not Ms. Linnemann's fault because she is not making the policy here. We, as lawyers, have always looked at the certificate of origin and if it comes from an unrelated supplier and it is facially accurate, we believe that there is no additional duty. You do not know that company, you are dealing at arm's length. If they give you a document that is facially accurate, we do not think that there is an additional duty to inquire. We have just heard from Ms. Linnemann that there might be.

In terms of a related company, we have an additional duty. The U.S. Customs Service looks at companies as a whole entity. Even if you are incredibly decentralized and the left arm does not know what the right arm is doing, Customs looks at you as one company. So in a related company situation, I can see that there is an extra obligation to go beyond inquire. You may look at it and say, "Oh God, there's no way that can be that one," or "I didn't know that had that much local content." So pay attention to the Certificates of Origin, that is the first thing.

The other thing I found in my experience that has been very interesting is the different approaches by the three governments on how NAFTA verification audits are done. We have differences of approach in so many different ways. For example, Hacienda[47] comes to your offices all at once; they blow in, they are there for a week, they do everything, they are gone, they write a report.

Depending on how complicated it is, Revenue Canada may not be there for more than 2-1/2 weeks, at a maximum. They usually start on a Thursday, they are there over two weekends, and then they go home. So they also tend to do their audits in chunks. They may come back a second time, depending on how complicated it is, but usually they are done in a couple weeks.

The U.S. Customs auditors seem to come when they feel like it; they come for a couple of days, they leave, six months later they come back again. I am being a bit over-dramatic here, but the way they work on their caseloads, it seems like they never spend more than a few days at one time.

So you have the contrast of either five days or two weeks of concentrated agony, or the slow water torture of having the drip, drip, drip, of Customs coming back for the seventh or eighth time. Not to be facetious; it has a very practical effect on the employees and management who are working on the audit. It is very disruptive to business. I cannot say for sure which is more destructive, but it is destructive.

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47. Secretaria de Hacienda y Crédito Público (Department of the Treasury).

I had a situation where I had the U.S. Customs Service do a verification of a Canadian subsidiary of a U.S. company, and then Hacienda came up and did a verification of the same Canadian subsidiary for the same product, at the same tariff rate, and Rule of Origin. This led me to think that maybe there should a little bit more coordination there.

I know for a fact in Illinois our state banks are regulated by both state and federal regulators. In Illinois, they have adopted what they call alternating exams. Rather than having the federal and state regulators come in every year and do the audits that they have to do, one year the state will do it and one year the federal government will do it, and the other agency will accept the exam. It seems to me that there should be a way; one, that there might be a little more consistency in how these audits are done; and two, maybe we can have a little bit more information sharing so there is not the need for each government to feel like it has to go in and verify independently.

What we find with audits, at least on the U.S. Customs side, is that it very much depends on who is doing the audit. We have a lot of Customs Service officers from the ports, particularly the southern and Texas ports, who will actually go and do a verification. Typically it will be a simpler one. They will go down to Mexico and verify that the tariff shifts are good. They will go down to where it was made, look at the raw materials and trace it all through.

U.S. Customs also uses their auditors, who still very much have an accounting approach to NAFTA. So even with the tariff shift, you are going into the financial documents and the production documents and you are not quite sure why. My experience, and it is not universal, is that with Hacienda it is more accounting-based, looking at the production records and financial records. It is the same with Revenue Canada. They seem to have more trained auditors doing NAFTA verifications. In the U.S. it can be a trained auditor or it can be another Customs Service officer.

Those are my comments in terms of NAFTA. Let me give you some other food for thought. I was listening to a National Public Radio report out of Detroit about a provision in the Immigration Reform Act of 1996 that became effective on October 1, which mandated the INS to check the papers of everyone coming in and out of the United States.[48] The INS has actually said that there is no way it can do that. The point of this particular story was that the northern border senators, particularly from Michigan, were really, really upset about it. So much so that the Senate is actually voting to repeal this issue and the House is talking about delaying it. The northern senators were saying that the Ambassador Bridge that goes over from Windsor to Detroit would be blocked forever and they would never get any goods through. In the meantime I do not actually know what the INS is doing. I also came across a press release from the U.S. Customs Service dated September 17, which actually said that the U.S. Customs Service was going to strengthen outbound border enforcement.[49] The way they were going to do that was by installing high-tech license plate readers in the southbound traffic lanes at San Ysidro,

48. Don Gonyea, *Papers Needed for Crossing U.S. Border* (National Public Radio, Morning Edition, Oct. 1, 1998) <http://www.npr.org/programs/morning/archives/1998/981001.me.html>.

49. United States Customs Service, *U.S. Customs to Strengthen Outbound Border Enforcement*, Sept. 17, 1998 Press Release <http://www.customs.treas.gov/hot-new/pressrel/1998/0917-00.htm>.

California. The point being that they want to not impede the flow of traffic but because they can read the license plates they will get the intelligence to be able to develop drug strategies.

So on the one hand, we have a fairly simple procedure for Immigration, which is basically, "Show us your papers," to make sure that people who come into the U.S., for example, on visitors' visas, go home again when they are supposed to. On the other hand we are building these high-tech license plate readers for the purpose of not stopping traffic. It was just mind boggling; I heard and read the two things on the same day, and I wondered if we are closing down the border or opening up the border.

There are a lot of other reasons for measures at the border, we have talked about health and safety. Trade is impacted with every single one. Something as simple as, "Show my your passport," and you can have a 23-mile long traffic jam.

According to the American Association of Exporters and Importers, a major trade organization, Senator Roth has proposed increased funding for Customs at the border up to $2.2 billion,[50] which basically is to lessen the significant delays in processing of passengers and cargo, when Customs Service people are diverted from enforcement to commercial operations. I do not know whether the problem will go away if we throw enough money at it.

There is one thing I wanted to talk about, and I will say this briefly with all due respect to Ms. Linnemann. Even though Customs is supposed to be kinder and gentler, they are still schizophrenic. They do not know if they are enforcing or helping. From somebody who has been working for a number of years with the companies (I will not say against the Customs Service because it depends what posture they are in at the time) it is interesting to see even in their compliance publications that there is still that little undertone of, "If you don't do it, we're going to make you do it." Almost what I call the nanny tone, "You will do it our way or we will make you pay." Part of it is the traditional mission of the Customs Service. They have been given too many hats. Now Customs is calling importers 'customers' but they will still serve you with a search warrant if they think you have been a bad guy. I do not know if it is ever going to get worked out. In the terms of NAFTA, it makes for some very interesting dichotomies in terms of how Customs officials react to importers, react to people who do NAFTA claims.

REYNA: Thank you, Ms. Preece. Now we continue on with our representative of the private sector from Mexico, Lic. Adrian Vazquez Benitez.

VAZQUEZ: Thank you very much. I would like to start by echoing something that Mr. Beteta pointed out. Mexico made important foreign trade changes during 1995-99. These changes were in tariffs. As Armando said, the Customs authority is the last tax collector. Mexico also eliminated the office price systems in 1988. Mexico is starting to develop non-tariff barriers such as technical standards, sanitary standards, health standards. We have implemented sophisticated rules of origin, which we did not have in Mexican legal practice.

Today because of all these changes, we have a very difficult tariff system. I say this because for every product that you import, you might have 8, 10, 12 or maybe 15 different tariff rates or averages that you have for a given good. For example, if

50. *International Trade Alert*, (American Association of Importers and Exporters), Sep. 28, 1998 at 1.

you import from Canada or the U.S. or from Venezuela or Colombia, you have different tariff rates, so you have to be an expert. You have to thoroughly follow all the changes in tariffs year by year in order to be stepping in the right direction, in order to know what tariff to apply. This has been a very important change in Mexican practice.

Also the anti-dumping and countervailing duty system has been very active in Mexico. Almost 1/5 or more of all Mexican import tariff is subject to an anti-dumping or countervailing duty order, so we have another tariff system there, just for anti-dumping orders.

What is the role of Customs today? To enforce compliance with the import obligations. Late in the 1970's foreign trade policy was always executed by Hacienda, the Treasury Department. Today SECOFI[51] is the one conducting the trade policy in Mexico. So SECOFI gets the clean work and Hacienda gets the dirty work. Not that the work is dirty, but they have to fight all the time with the importers and exporters.

We should ask this question, are customs procedures really trade barriers or not? Do, as Mr. Beteta was saying, customs procedures and customs practice by Mexican Customs officials constitute trade barriers or not? For that, let us analyze particular Customs figures, such as the customs broker which Mr. Beteta was telling us about. There is always a need, in most of the cases, for a customs broker to do import and export operations. This is an official service; the customs broker is given a special authorization by the Mexican government to perform effect customs operations. So the customs agent or broker is a bridge between the importer and the tax or customs authorities. He should be a good classifier of merchandise and he should also be an import advisor for the company.

Customs brokers in Mexico are our legal competitors because they also give legal advice on import operations. At the end of the day, because they always screw up, they come to us and say, "They are going to cancel my authorization, can you defend me?" "Well, you should have made a correct classification. You are not well acquainted with the general import rules, the interpretation or the complementary rules of interpretation."

This also applies to the attorney-in-fact customs brokers, which are in-house employees of the particular company. These in-house brokers serve more, and I have seen this type of authorization, in the automotive industry. These in-house brokers work very closely within the automotive sector more than 90% of the time.

Another issue is whether the random selection mechanism is a trade barrier or not. Mr. Beteta was saying that it does not constitute a trade barrier. Let us see. Last year there was a very interesting panel on the anti-dumping case of apples.[52] I think this is an important case to consider again. As you know, the apples case in Mexico was ended by a Suspension Agreement. This means that in the U.S. producers, growers of apples, entered into a suspension agreement on a certain export price to Mexico. They would not export under a certain level of price to Mexico.

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51. Secretaria de Comercio y Fomento Industrial, the Mexican Ministry of Commerce and Industrial Promotion.

52. Michael W. Gordon, et al., *Agricultural Disputes: Mexican Tomatoes to Florida and Washington Apples to Mexico*, 6 U.S.-Mex. L. J. 117 (1998).

So in complying with the Suspension Agreement, what happens at customs houses? Every shipment of apples that goes into Mexico goes in the random selection mechanism, and what a coincidence! It is red every time! So the merchandise has to be inspected. What happens the second time they go? Well, what a coincidence red light! This happens in 100% of the cases. Mr. Beteta was saying that 10% of all the cases go to a red light, and 1% of that 10% goes to a second red light. Well, you can see that in the apple case, it is 100% of 100% of every 100%. Does this constitute a trade barrier or not?

Another issue I want to touch on is the import record system that is handled by the *Servicio de Administración Tributaria* (SAT), the Tax Administration Service. The import record system is provided in the law and in the regulations of the law. There is another provision that establishes the sector import record system, which is a particular type of import record system, so it is like a subspecies. Not all the products are subject to the sector import system, but there are some very important sectors such as, what a coincidence, apples again, steel products, toys, beer and others. If you want to register in the sector registry you have to comply with all the customs law regulations and the foreign trade rulings, provide specific information, and present all your documents. Guess who makes the checklist of who is going to obtain his sector registration? The national producers, because they form part of the committee giving the authorization to be granted or to be registered in the sector registry.

This means that an apple importer, for example, comes and asks to be in the sector registry and does not have the authorization, but is complying with all the information. So, what does the customs operator do? He says, "You did not provide me the A-3 (for example) document. It is the green order that you have to fill in." Okay, you fill it in, and, "Now you forgot to bring the information from the last three years of all your operations." Then they provide the information, and at the end of the day they tell them, "Okay, in two weeks you will have your registration." So they come back to the customs authorities in two weeks and ask, "Okay, give me my authorization." "Oh, what do you think! We lost your file. You have to comply again with all the information." At the end of the day, only ten, fifteen or twenty importers get the opportunity to import certain merchandise. Of those twenty importers of apples, ten are national growers of apples. So you can see that there is a trade barrier there.

Tariff classification is a very important and very unique legal analysis system. The customs broker is the authorized person under Mexican law to classify the merchandise. However, if you have doubts if you have to import under one certain classification number or another, you have to ask the customs authorities to give you a specific ruling where you should include the merchandise. Believe it or not, I have seen in practice that the specific rulings that Hacienda gives to the importer that is requesting this information is coincidentally the tariff number in which they have to comply with the most tariff barriers. For example, if you import a product that looks like a toy but is not a toy, Hacienda might say that it is a toy and you have to comply with the specific number applicable to toys.

The import procedures that Mr. Beteta was telling us about seem very easy. However, even if you have been recognized one or two times by the customs authorities, they still have the authority to verify all your trade operations - one, two, three, four years afterwards. So even though you have complied with all your

trade operations and they verified the information and they authorized all your information at the Customs House, this does not preclude the customs authority to review your import operations afterwards. Maybe you made an error. In 99% of the cases I have seen, the customs authorities determine that you have not complied with all your import requirements, and that you have fiscal credits to pay to the customs authorities.

There is another very important figure in the customs line in Mexico, which is the *deposito fiscal*, which is the fiscal deposit or the tax deposit. Duty-free stores at the airports, for example, operate under this system. You import the merchandise and the tariffs are determined on the date in which the merchandise entered into the fiscal deposit. Even though you take the merchandise out one year, you will pay only the duties that were applicable at the time when you presented the merchandise into the fiscal deposit.

Finally, I want to tell you that it has always been a joke in Mexico, the legal hierarchy of the law.[53] For example, in the pyramid you have the customs law, then the regulations, then the foreign trade rulings, then the specific rulings to importers, and so on. It is a joke because the specific rulings overturn the law! They go over the law. They say, "Memos to Customs Houses are over the law." This means that although you are complying with the law, the regulations, or the rulings, a specific memo from the customs authorities in Mexico City gives a specific mandate to a customs house administrator in, let us say, Laredo or Ciudad Juarez, and he must comply with that specific memo, even if the law and regulations for foreign trade rulings say otherwise. This means that in practice, the regulations are over the law; the foreign trade rulings are over the regulations and over the law, and specific memos are over the rulings, the regulations and the law.

Thank you very much.

REYNA: I would like to give Mr. Beteta and Ms. Linnemann the opportunity to make any comments with respect to any comments that Ms. Preece and Ms. Vazquez made.

BETETA: My first critical observation is regarding the random selection mechanism, the 10% that I pointed out. Of course, I told you 10%, which is the general rule. However, I did not point out that we are dealing with a computer which is intelligent. By this I mean that the computer will detect those shipments which might have extra requirements or might be delicate to inspect. The government facilitates trade, but is aware of not letting everything in, for example, a shipment of firearms. Of course that is the extreme; we are dealing with apples, which is another issue. The random selection mechanism tends to facilitate the procedure but it does not mean that it will let everything in. So even though the tendency is 10%, it will not be applicable all the time.

Regarding the specific sector registry, this registry is kept for statistical purposes first. Also, as I stated before, NAFTA is a preferential duty agreement; it is not immediately a free trade agreement. It is eliminating the obstacles to trade in a periodic way, in order to avoid a huge impact to the economy of a country. So

53. *See* La Constitución Política de los E. U. Mexicanos, Feb. 5, 1917, at Art 133-Supreme Law of the Land; Sec 2-Introduction and Enactment of Laws, Art 71-Right to Introduce Legislation, Art 72-Procedure to Enact into Law.

another basic reason for this registry is to detect which fields and industries in Mexico might need some protection, or at least have a register of what is going on in those fields. The sector registry is important in that sense.

In regard to the classification numbers, of course I have found out in my position representing Mexico at the NAFTA Center, that there are a lot of questions regarding classification numbers. The general rule is that the broker in Mexico should provide that classification number; however, a lot of times there are problems, a lot of questions regarding these. That is why the law creates a committee on classification that takes into consideration and includes members from the private sector. So it is not only up to the judgment of the authority to decide on applying the classification that has the highest duties for a certain product. You might have been experiencing that problem in practice, but at least today we have this committee in law. I think our task is to be aware of and try to improve the errors in implementation.

Let me also mention something regarding the hierarchy of laws. Mr. Vazquez Benitez and I are both attorneys; we know that the Constitution establishes a very clear hierarchy of laws.[54] Of course, if a specific administrative ruling goes against the law, it should be noted, and there are different legal means to overturn that. I am aware that there are some rulings that might be going against the law and I think that the position from the private sector should be to fight that and overturn that if such is the case. The idea is to do everything within the hierarchy of laws: constitution, law, and regulations, in that order.

LINNEMANN: Regarding a couple of things Ms. Preece brought up, and on one I agree totally. We just decided we have 'customers,' as I said. Ms. Preece has different thoughts on how we look at those customers. Looking at the data, the indication is that from 1990 to the year 2000, trade is going to double. Looking at our number of employees from 1995 to 1999, we have lost 2.8% of our workforce. So we have to somehow work to deal with this vast quantity of trade coming in, and dealing with people as customers is the way we want to do it, recognizing of course that we are an enforcement agency and that is our number one goal in life. So it is schizophrenia by design; it is not just random schizophrenia, we do it on purpose.

On customs verification, she brings up a good point on everybody going in at the same time. Although it is a trilateral agreement, the three countries very much hold their ability to independently make decisions and do verifications.

In the United States we have set goals on the number of verifications we will do and we have the computer randomly generating a number of verifications; 850 mandated verifications this year were randomly generated by the computer and then there are another 5,000 to be done by the ports themselves. So I can see, again by design, that they could be walking on each other, and problems could arise in that area just in enforcement of the law. It is something that we have to look at, and part of why my staff is looking at the database is to say, "You have looked at this company for this commodity three times and they have been compliant every time, go away and look at somebody else. Don't waste the facilities and the manpower that we have on something that is compliant."

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54. *Id.*

REYNA: Mr. Beteta, I have a question. I am an exporter in Illinois and I am doing a lot of shipments to Mexico and I am kind of getting tired of my customs broker, and I have the feeling that he may not be the person that I need and I want to have my own in-house customs broker. In fact, my nephew just graduated from the University of Chicago and I think he is brilliant. I have hired him and would like for him to be my in-house customs broker and I go to Mexico to do that. Can I do that?

BETETA: Yes, you can, and that is one of the other important differences, that while a customs broker needs to be a Mexican citizen–

REYNA: My nephew is not.

BETETA: –an in-house broker can be foreign.

REYNA: Okay. Mr. Vazquez Benitez, how do you view the process of qualifying to be an in-house customs broker? Do you think I have a good shot at getting my nephew in?

VAZQUEZ: Well, if it is a nephew, I do not think so. You have to comply with certain rules. One of those is the same as the customs broker, you have to pass a specific exam and then there is going to be a lie detector exam. When they give you a lie detector exam, they ask you, "Have you ever stolen anything?" Maybe they went to a store once and stole candy, but they would say, "No, I have not ever stolen anything in my life." The lie detector will say, "Hey, he is lying." So maybe those are the types of barriers that the Customs authorities may put before in-house customs brokers. I do not know of any foreign in-house customs broker working in Mexico. I know of Mexican in-house customs brokers working, as I told you, only in the automotive industry.

BETETA: In your hypothetical, I do not think he could qualify as an in-house broker because you said you are a Peoria corporation, so you are not qualified to do business in Mexico. However, you are importing, doing business in Mexico. So first you have to form a subsidiary, or have a branch which meets all the corporate law and commercial code requirements. So it is not that simple and you need to keep in mind other legal aspects.

REYNA: Okay, so it turns out that in order to do this, I have to maintain a physical presence in Mexico. If I set up just a sales rep in Mexico, is that enough?

VAZQUEZ: Well, I do not have the listing of all the requirements. Definitely, I believe you would need to have some physical presence there, not just doing it from the United States.

REYNA: Do I have to have an extensive distribution network or distributors? Or would a franchise be enough? Or how about if I just send my other nephew down there, have him open up a sales rep office with just him? I give him some supplies, some samples, would that be enough?

VAZQUEZ: As long as he goes through the exams and he qualifies, I would not see a problem. I do not see a problem in that specific situation.

REYNA: Are you aware of any foreigners passing the exam in Mexico?

BETETA: Not really.

REYNA: It seemed like it was a dismal failure rate, about 99% of all of them were failing.

BETETA: To be honest with you, I have not seen the numbers. I believe that one of the biggest courier companies has an in-house broker. I do not know if it is UPS or FedEx. One uses an in-house broker and one uses a customs broker.

VAZQUEZ: Yes, I just wanted to clarify something. The in-house brokers work for importers only. To be an importer, you need to be established under the laws of Mexico, having a tax income number and you also have to be registered. So then when you hire a person who will act as your in-house customs broker, he is acting on behalf of a Mexican importer company.

REYNA: It happens to be that the product that I am sending down there is glass and that is viewed as an import-sensitive product. You were just telling us that the registry of importers, that there can be some problems. Armando, you were saying too that it is set up in a way to detect importers that may pose a problem, or any products that are imposing a problem. I am importing glass. That is an import-sensitive product for Mexico. Am I going to have a problem with that to give my in-house broker or to get my importer registered?

BETETA: Not really. Basically you would be using an in-house broker. If you would have any problem, the in-house broker would have the same function as a regular broker so he would have to follow the same steps as a broker would do for importing this specific product. It should be registered in the sector registry.

REYNA: You heard the comment made that sometimes in Mexico a ruling can supersede or has the effect of superseding the law as well as the regulation. Does that ever happen in the U.S.? Do you ever come across an instance where either a ruling does not make sense or the application of it supersedes the law?

PREECE: I would not say that it supersedes the law. Sometimes the interpretation is totally wrong, but that is a little bit different.

I do not know how much everyone is aware of the ruling process in the United States, but we have a fairly transparent process. U.S. importers and now through the NAFTA, Mexican and Canadian exporters, can apply directly to the U.S. Customs Service for classification ruling, valuation, marking. The way it works is you apply directly to the U.S. Customs Service and there are a couple of administrative routes that you can take.[55] You can get a ruling which is binding on you. If it is wrong, you can get them to reconsider it. If it is still wrong, you can go to court with it. All of this is available, it is published. For example, the U.S. Customs website has a listing of every NAFTA ruling that has been issued by the U.S. Customs Service.[56]

REYNA: Let us say I have not personally obtained a ruling for my glass product. If I find a ruling that has already been issued on the classification covering my product, does that apply to me?

PREECE: In the United States the ruling is binding on the specific transaction in front of it. However, in the United States other importers with identical or similar facts can rely on that ruling. It may not necessarily be precedent, as it is not binding on everybody. The ruling itself is binding only on the person who asked for it from the United States Customs Service. That does not preclude anyone from relying on it. As I say, not just in NAFTA, but most Customs Service rulings are published and now they are on the Internet. It is very easy to get hold of them.

REYNA: Okay. Well, my nephew has not made it down to Mexico yet. I still do not have any type of physical presence. Mr. Vazquez Benitez, can I go and find a similar system in Mexico with respect to a Customs ruling, make a search on the

55. See Customs Duties, Administrative Rulings, 19 C.F.R. 177.0 (1999).
56. Available at <http://www.customs.ustreas.gov/nafta/nafrul.htm>.

Internet, or send somebody to do some research to see if there is a product ruling that applies to me? What would be involved in that?

VAZQUEZ: In general practice, no. The fiscal authorities or the tax authorities are only authorized to respond to real and concrete situations. You have to present the situation to the customs authority, and tell them, "I intend to import this product. I have doubt where it should be classified." Then you also have to present your tax income registration number which means that Hacienda will know what type of operation you are doing and will have the ability to verify your trade operations.

REYNA: I do not have a tax registration number.

VAZQUEZ: If you do not have one, you will not obtain a particular ruling from the tax authority.

BETETA: That is true, except in the case of an advance ruling, where there is a specific entity that deals with foreign residents. I wanted to clarify something because it sounded very tough, and that is the statement that in Mexico rulings might go against the law. Of course rulings in Mexico should be *fundados*, well-founded. If a person thinks that it is going against the law, he has the legal means to impeach that. The rulings should be *fundados*, based upon law.

REYNA: Okay. If I find a ruling similar to my product in Mexico using this special process that you mentioned, does the same process work? Can I rely on somebody else's ruling?

VAZQUEZ: You can rely on that ruling whenever you are submitting your situation, and say, "I know that about this situation which was resolved in that way." That might help you as proof; it might not.

REYNA: Are these rulings publicly available?

VAZQUEZ: No, not at this point.

BETETA: They are not publicly available, but the Customs authorities always provide them to the National Association of Customs Brokers. They give them the most recent rulings on customs issues so they can deliver particular rulings to all the association of customs brokers in a particular city. That way the customs brokers will know what ruling to apply, even though the specific ruling was given to a particular company. However, in this situation, the customs broker will apply that ruling.

REYNA: Ms. Linnemann, is there any information regarding reliance on advance rulings under NAFTA? Has there been an increase in the use of that procedure?

LINNEMANN: I do not know that there has been an increase. We have had really good response to the rulings program overall. Given the fact that it has been in effect for three years, there are not a horrendous number of rulings. It would be nice if there were more.

BETETA: In the case of Mexico, we have a very low number of advance ruling requests. Of course we encourage people to make requests.

REYNA: I can recall the time not too long ago when very few people in Mexico knew what rules of origin were, and the whole system was not as advanced. Now the system is not only advanced, but pretty complex. Can you help define what the rules of origin are? There is one for NAFTA, there is one for Most Favored Nation purposes. Are there others? What are the others?

BETETA: There is a lot of confusion regarding the NAFTA. I am going to give the basic two rules that people get confused with. The NAFTA Rules of Origin are specified in Annex 401 of the Agreement. They determine if your product originates

in North America. If your product complies with that rule, then you are eligible to receive that treatment.

There are other NAFTA-related rules, which are the NAFTA Marking Rules and they are very similar to the Annex 401 rules. These rules determine if you are going to be able to mark your product as a U.S. or as a Canadian product in order to see what type of duty you will benefit from.

There are also the rules of origin related to *cuotas compensatorias*, anti-dumping duties. For example, products coming from China might be subject to these duties for anti-dumping purposes. You have to fill out a certificate of origin in some of these situations. There are several ways to avoid that anti-dumping duty; one of the ways is to fill out your certificate in accordance with some specific rules of origin that will allow you to say, "My product is not from China, it is from Germany and therefore I can avoid the anti-dumping duties." We are facing all these rules, and I agree with Adrian, it makes it very complex some times.

REYNA: Ms. Linnemann, I have been hearing a lot of talk under the Modernization Act about informed compliance, and now I understand that the hammer is about to fall. Do I still have some grace time left? When is it that you are going to go into enforced compliance?

LINNEMANN: If someone is deliberately committing fraud, where they know what the rules are and they do what they want to do anyway, the hammer is going to fall as soon as we discover this. For everyone else, it will be, "What efforts did you make to determine what the rules are? Did you hire a broker? Do you meet with your broker to determine what the rules are? Do you hire a customs attorney if your business is large and complex or you have a commodity that is more complex than others? What have you done?" And if you have not done that, then you need to start taking those steps right away. The theory is that reasonable care began when you began importing, not when the Modernization Act became effective in December, 1993.

REYNA: Now, I am kind of tense about the thing, and I go to Lynn Preece, and I say, "Lynn, I would like for you to come over and do what it is that you need to do in order to make sure that I am up to speed. I hear the hammer may fall. I am concerned I may be one of those who has already run afoul. We used to go around and shop for ports that presented the most favorable basis. One of our customs directors might have been kind of fast and loose with some of the things, so come over." What is it you would tell me, what would you do to help me out?

PREECE: Depending on how large the company is, typically I go in and do a mock audit before the Customs Service comes. I go through the company and see whether you just have customs problems, whether you have things that are serious enough that you have to get them straightened out right away, or whether there are things that you are doing okay but you could be doing much better. Also there are times where I go through and say, "You could be saving some money if you do it this way instead of this way." I really call it compliance review. Basically we are advising the client on how to get their house in order so that if and when Customs does come and say they want to do a compliance review, they are ready.

I read a report of a trade meetings in which a senior U.S. Customs officials basically said, "If you start your compliance review when you get your letter from us, it is too late." If you get to the point where you are getting nervous, that is the first step.

The other thing is that even the companies that are really good, or pretty good at this stuff, never ease up. There is always a way they can get better and better.

Basically you go on a fact-finding mission and if you have some serious problems, you make sure that you find every one of them. Then you walk in and smile sweetly at the Customs Service—well, actually, you send them a letter with a check. Basically you disclose all your prior sins before they find them, and for a very good reason. It is not just to get back into their good graces. Under the Customs penalty statute,[57] if you voluntarily disclose wrongdoing and pay back duties before Customs knows or before they initiate an investigation, any penalty that you may be assessed for your negligence or gross negligence in doing so is severely limited. We usually go through a chart that shows, "Well, these are the penalties if you do not do a disclosure, and these are the ones if you do." There is a substantial difference. So there is a very practical business-like reason to do that. As a practical matter, it clears the air so you can get compliant. Sometimes it is just a question of convincing people that they need to do it.

REYNA: Mr. Vazquez Benitez, do you do something similar in Mexico?

VAZQUEZ: Yes, we do. However, I would say that in Mexico the foreign trade culture is not as big as in the U.S. or Canada and the importers say, "Well, what are the chances that I am going to be verified by the Customs authority?" "One in 1,000." "Oh, come on now, I am never going to be verified." If all of a sudden the company is verified by the Customs authorities, then they just have a mess and destroy operations. So we do work with customs compliance, we make foreign trade audits. What is more important than the foreign trade audit is not only the tariff barrier but also the non-tariff barriers and their compliance. However, I would say that the non-tariff barriers constitutes the most important part of the work we must look at when we are auditing a company.

PREECE: I did not want to seem over-simplistic, but obviously when you are looking at a prior disclosure, you have to do it very carefully. First of all, you have only one shot at it. Second, if it looks like it could be possible criminal conduct, then you may have to weigh that against the fact that you may limit your potential civil liability. The reason we do it in the United States is because the penalties can be so large. The penalty for fraud is the U.S. domestic resale value, and if you have two or three years' worth of product, it can be very large. Customs really gets stars in their eyes when they get into multi-million dollar penalty situations and it is perfectly possible to have these kinds of figures going around. A very big motivation from NAFTA, particularly with larger companies and publicly traded companies, it that a penalty is a contingent liability that has to be shown on your books. So if you can limit that liability, there are very sound business reasons for doing it. Obviously it depends very much on the facts of the situation and what the problem was, and whether you are going to get thrown in jail for it.

REYNA: Okay, questions from the audience, please.

MITCHELL[58]: This question is for Mr. Vazquez Benitez. You mentioned an interesting statistic, which I am sure is a generalization, that approximately 1/5 of

57. Penalties for Fraud, Gross Negligence, and Negligence, 19 U.S.C §1592 (1998).

58. Mr. Bruce Mitchell is an attorney with Grunfeld, Desiderio, Lebowitz, and Silverman, L.L.P. in New York City, NY.

the imports coming in to Mexico are subject to dumping or countervailing duty orders. That is a staggering amount. Who determines whether you are in the scope of the dumping order? For example, in the U.S. that is the province of the Commerce Department; Customs does merely administrative functions and if there is a scope issued, they have to send it back to the Commerce Department.

REYNA: Bruce is talking about the determination on a particular product, if there is a dumping order that covers, let us say, glasses—here I am holding two glasses and I want to know if this glass that I manufacture is covered by that dumping duty order or not. That is the scope ruling, you try to determine if the product falls under the scope of the anti-dumping duty order.

VAZQUEZ: Mr. Mitchell, the scope reviews or investigations are done by SECOFI. We have to distinguish between the scope reviews that could be very technical and the ones that could be very easy. The ones that appear very easy, you could go to the Customs authorities and say, "I do not have to pay a duty for this because this is not covered by the order." Customs could say, "Okay, you do not have to comply with the anti-dumping duty." However, Customs never acts like that. You would always need a confirmation of criteria from the Department of Commerce in Mexico and you would automatically ask SECOFI if this product is subject or not.

The most normal way of approaching this situation is asking SECOFI directly if a certain product is covered or not by the order. SECOFI would then publish a resolution saying that certain products are not subject, or are subject, to it. For example, we have a case in stoneware. The anti-dumping duty was on stoneware from China both in sets or just in plates, but it only mentioned one tariff classification number. So the importers started to import through another item classification, saying they were importing only plates and dishes, and they were not subject to the order. That particular situation had to be handled by SECOFI because it made an error by classifying those products under only one item number, whereas they should have been classified under two separate item numbers.

BETETA: Those are public resolutions, they are published in the *Diario Oficial.*

VAZQUEZ: Yes, the resolutions from the Department of Commerce are published in the *Diario Oficial.* However, the rulings which periodically identify which items are covered by anti-dumping or countervailing duty orders are published every two years. So you ought to be following all the resolutions from SECOFI in order to know if you are subject or not to a dumping duty. Because Customs does not publish all your import barriers and non-tariff barriers, you have to pick up this resolution and this ruling, and then this one and this other one and you have to research your own tariff in your office. Customs does not do that work, although it should do that work for the benefit of the importers that cannot hire lawyers or do not have the resources. They need very transparent tariffs from the Customs authorities and they do not have them.

PREECE: We have been talking about some of the other issues that affect trade, such as health and safety. This comment is meant kindly. I think sometimes the customs inspectors put their own health and safety on the line by not being aware of what the products are.

I leave you with two anecdotes, both of which are true. The first one involved an incident on the northern border with an inspector who wanted to take a sample from

a tanker of liquid oxygen, and the driver just said, "Would you give me twenty minutes to get far enough away from here."

The second one, which could have been even more serious, involved an inspector who believed that he was on the trail of illegal shipments of Cobalt 60 to China. A client of ours actually had sold a radioactive product to a customer in Texas. The Customs Service asked my client if it was really as invoiced, which was as Cesium 137, and we said that yes, it was. He did not believe us and he opened up the canister. All I can say is that he was very lucky that it was not Cobalt 60, because he would have been dead! So health and safety works both ways, and this is just a plea to the inspector. If they do not know what the product is, ask the company, as most of them are honest and they will tell you exactly whether they are dangerous or not.

REYNA: Thank you. I think the discussion by this panel bears out that corporate financing considerations also need to include customs-related matters, and they also need to include matters related to international trade, and, as Adrian was saying, the difficulty in bringing all that information together. You must consider contingent liabilities like Lynn pointed out, where you can have a $100 million liability for a company that is sitting out there because of prior activity. That should be considered when you are reviewing financing or other types of corporate considerations for a particular company. Other considerations are, where are these laws headed? As Sue pointed out to us with informed compliance, and now with enforcement, we have a new structure that companies will be facing with respect to how they handle record keeping requirements within the office. Finally, another consideration is the other types of resources available to the company, such as Armando pointed out in his discussion and his identification of resources that are available to companies that are doing business abroad, especially in the U.S. and the Mexican market.

I thank this panel for their expertise, the information that they shared with us, the illustrations that they provided, and I thank you all for your attention.