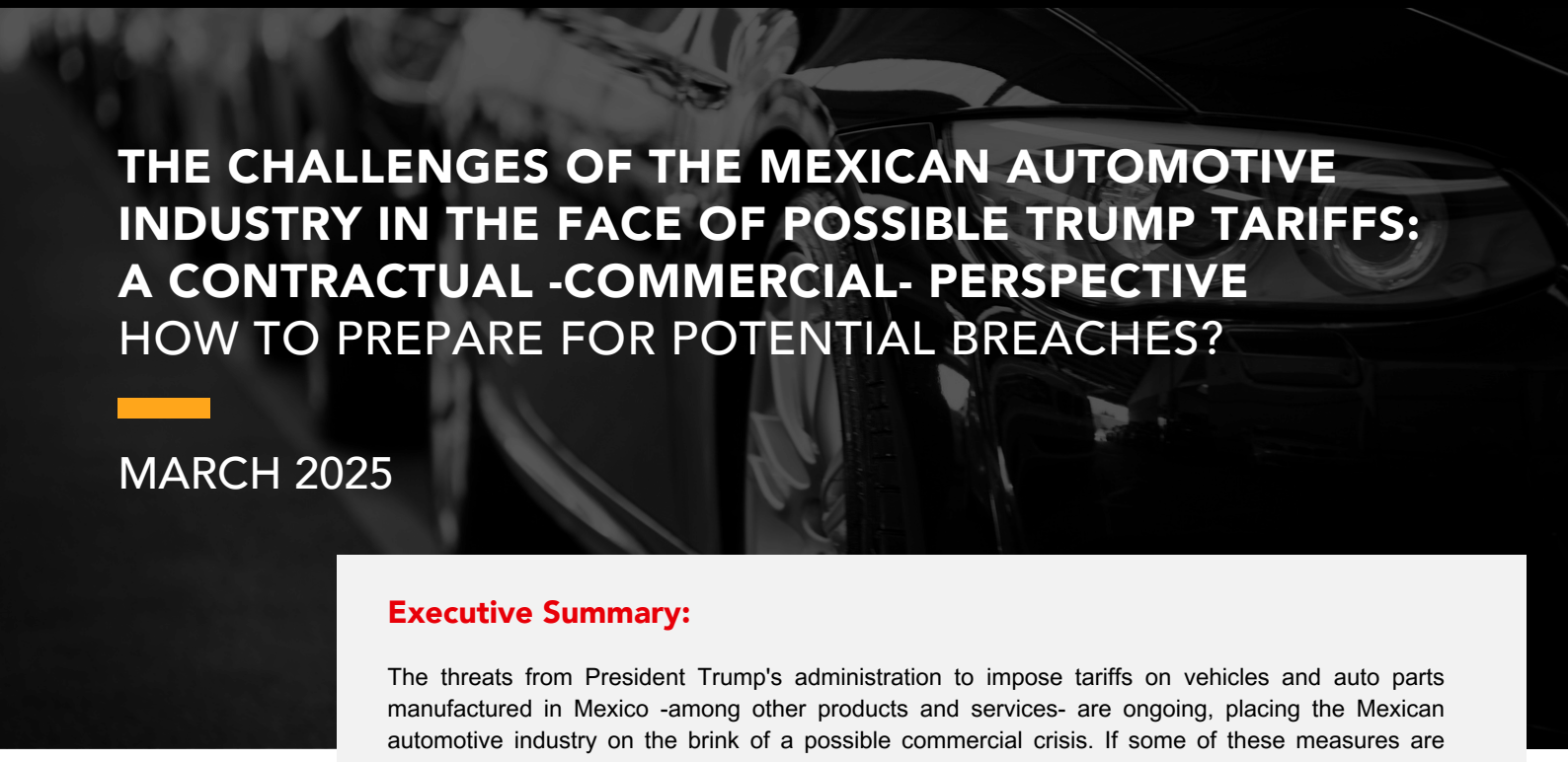

THE CHALLENGES OF THE MEXICAN AUTOMOTIVE INDUSTRY IN THE FACE OF POSSIBLE TRUMP TARIFFS: A CONTRACTUAL -COMMERCIAL- PERSPECTIVE

HOW TO PREPARE FOR POTENTIAL BREACHES?

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Executive Summary:

The threats from President Trump's administration to impose tariffs on vehicles and auto parts manufactured in Mexico -among other products and services- are ongoing, placing the Mexican automotive industry on the brink of a possible commercial crisis. If some of these measures are implemented, companies in the sector (from assemblers to Tier 1 suppliers) could face significant financial impact, but also a legal challenge in their contractual relationships.

How could they prepare from a legal standpoint to mitigate the effects of this scenario?

CONTRACTUAL BREACH AS AN IMMINENT RISK

It is no secret that automotive companies operate under commercial contracts with clients and suppliers that establish prices, delivery times, and very specific obligations. In particular, fixed prices in costs, number of available parts, delivery times, and penalties for delays are the daily routine for both assemblers and the various suppliers working around them. In the automotive industry in general, there is no room for distraction, breaches, or unforeseen events.

A tariff increase can drastically alter production and logistics costs, which could even make some contracts between companies in the sector unfeasible, for example, in relation to production costs or even regarding transportation and shipping expenses. All this could lead to contractual breaches, either due to the impossibility of delivery under the agreed terms or due to the lack of profitability of existing contracts.

PREVENTION AND MITIGATION STRATEGIES

To prepare for the possible imposition of tariffs, automotive companies can adopt several legal strategies:

1. Review and renegotiate current contracts: Incorporate force majeure clauses that allow contractual adjustments in case of significant tariff changes.
2. Contractual shielding in new agreements: Include price adjustment mechanisms and automatic renegotiation in case of extraordinary events.
3. Preparation of legal strategies regarding current contracts: Analyze the obligations, terms, and scope of commercial agreements and/or current contracts, in order to anticipate potential breaches and begin preparing the respective legal strategies.

While the potential tariffs represent a real threat to the Mexican automotive industry, adequate legal preparation can help mitigate their impact. The key will be anticipation and contractual flexibility to adapt to an increasingly uncertain commercial environment.

Specifically, regarding the legal strategies to analyze, develop, and implement in the face of Trump's tariffs, particularly in relation to current commercial and contractual relationships, it is worth asking:

Can tariffs be considered an unforeseeable act that allows the modification of commercial agreements?

THEORY OF UNFORESEEABILITY

The theory of unforeseeability (*rebus sic stantibus)* is the exception to the principle *pacta sunt servanda*, which establishes the binding nature of contracts.

Therefore, the theory of unforeseeability can be defined as: *"...that which allows the revision of what was agreed by the contracting parties, to resolve or modify it when, due to extraordinary, unforeseeable, and external circumstances, the conditions of its execution are notably altered, making the fulfillment of the obligation excessively burdensome due to the imbalance between the counter-performances..."* (Tapia, Javier. Theory of Unforeseeability).

The civil codifications of some states in our country have incorporated provisions that reflect the theory of unforeseeability (rebus sic stantibus), which allows us to argue that the change in circumstances due to unforeseeable events gives the right to renegotiate the terms of a contract. This issue can be observed in the local civil regulations of Mexico City (article 1796 Bis), Aguascalientes (article 1733), Jalisco (article 1795), Guanajuato (article 1351), Coahuila (article 2147), Sinaloa (1735), Tamaulipas (article 1261), Veracruz (article 1792), and the State of Mexico (article 7.35).

However, in the realm of the Federal Civil Code and the Commercial Code, the theory of unforeseeability is not regulated, coupled with the fact that judicial criteria issued in this regard mostly align with a conservative and legalistic position tending to reject the applicability of this theory in commercial matters.

Consequently, at first glance, it seems that in federal civil and commercial matters it is not possible to argue a "change of circumstances" as a fact generating the power to renegotiate a contract due to excessive burden or imbalance in the contractual relationship, although the position of Mexican Courts could change, e**specially in the context of the election of Judges derived from the Judicial Reform of 2024.**

IMPOSSIBILITY OF PERFORMANCE AND FORCE MAJEURE

In the legal field, the concepts of impossibility of performance and force majeure are essential to under understanding situations in which a party cannot fulfill its contractual obligations due to unforeseeable and unavoidable external events. In general, legal doctrine has defined these concepts as follows:

- **Impossibility of Performance:** Refers to natural events that cannot be prevented, such as earthquakes, hurricanes, or floods.

- **Force Majeure:** Refers to events caused by external factors, often by third parties or authorities, that make the performance of a contract impossible, such as wars, seizures, or drastic changes in legislation.

Both concepts can relieve the affected party from liability, provided it is demonstrated that the event in question was unforeseeable and truly impedes the performance of the obligation in question.

From a legal perspective, the question arises: *Can this new tariff policy be considered impossibility of performance or force majeure in commercial contracts?*

While the imposition of a tariff does not directly prevent the performance of a contract, it can significantly alter its economic conditions, making it excessively burdensome for one of the parties. In some contracts, such a regulatory modification could be interpreted under a force majeure clause, allowing for renegotiation or suspension of certain obligations. In other cases, recourse could be made to the theory of unforeseeability, as described earlier in this article.

UNIDROIT PRINCIPLES AND CONTRACTUAL RENEGOTIATION

The UNIDROIT Principles on International Commercial Contracts can offer guidance to face these challenges. In particular, the principle of "hardship" establishes that, when an unforeseen event fundamentally alters the contractual balance, the affected party can request a renegotiation. Although these principles are not binding by themselves, they can be used as a reference in international commercial disputes.

For their part, the customs and practices of merchants are concentrated in the Lex Mercatoria, with international practice and doctrine confirming that the UNIDROIT Principles are part of it. These principles regulate the general rules applicable to international

commercial contracts, providing for the figure of "excessive burden" and its effects on contracts, particularly the power of the disadvantaged party to claim the renegotiation of the contract.

Additionally, the American Convention on Human Rights defines usury as any other form of exploitation of man by man, which must be prohibited by law. This principle has been adopted by our highest courts and applied in their rulings, to the extent of issuing jurisprudence that empowers judges to study ex officio the interest agreed upon in civil and commercial contracts, in order to prudently reduce it when the interest is considered excessive and abusive.

Considering the above, companies could attempt to renegotiate their contracts under the theory of unforeseeability. To do so, it is crucial to consider:

(a) The deadlines with which the affected party has to notify and assert the extraordinary, unforeseeable, and external circumstances (in our case, the entry into force of Trump's tariffs);
(b) Proper notification to the other party; and
(c) The specific terms agreed upon in each contract, to determine the application of this theory, as well as the scope it may have in modifying the obligations agreed upon in the contracts.

At Santamarina+Steta, we are already analyzing and working on strategies to be implemented by our clients, so we consider it important that, if you believe your company may be affected, seek prompt and immediate advice.

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