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China energy storage system

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EQUITY: TECHNOLOGY

USMCA's potential impact on ESS

Rule of Origin and Regional Value Content may put Chinese ESS firms' Mexico-based supply chain at risk

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Background: A trade compact under strain

The United States-Mexico-Canada Agreement (USMCA), which replaced the North American Free Trade Agreement (NAFTA) in July 2020, contains a mandatory six-year joint review clause that allows any party to extend, renegotiate, or terminate the agreement (*Fig. 1*). The formal review period formally opened on 1 July 2026, following a US Trade Representative (USTR) public comment period launched on 16 September 2025, a statutory USTR report to Congress filed on 3 January 2026, and the US-Mexico bilateral review launched on 5 March 2026. As of April 2026, negotiators are engaged in regular structured meetings initiated on 16 March 2026. The review does not automatically terminate the agreement — with the absence of a consensus to extend, the USMCA enters the annual review mode.

USMCA negotiation is likely to close the gap between Section 301 Origin Rules and Preferential Tariff Eligibility

Battery Energy Storage Systems (BESS), classified under Harmonized Tariff Schedule (HTS) code 8507.60, are not automotive products but have become a focal point of USMCA trade dynamics because Chinese firms may have routed lithium iron phosphate (LFP) cells manufactured in China through Mexican assembly operations to supply to the US market while potentially qualifying for preferential tariff treatment. Under current USMCA rules of origin (ROO), BESS cannot satisfy the Change in Tariff Classification (CTC) method — battery cells (HTS 8507.90) and battery packs (8507.60) fall within the same tariff heading — so qualifying products must instead meet the Regional Value Content (RVC) threshold of at least 65% under the transaction value method or 55% under the net cost method. A 2021 US Customs and Border Protection (CBP) ruling (HQ H316545) confirmed that battery cells represent the "essence" of a battery pack for Section 301 tariff purposes — meaning country of origin follows the cell — but USMCA preferential tariff treatment can still apply if RVC thresholds are satisfied. This legal asymmetry is the arbitrage at risk in the current negotiations. We assess three outcomes for the 1 July review: 1) a 16-year extension with no renegotiation; 2) a modified extension incorporating new ROO thresholds and Chinese equity restrictions, which could impair the Mexico assembly route; and 3) annual review mode without a long-term extension, which may put negative pressure on capital expenditure.

Likely US negotiation position

Based on industry survey and our estimates, the US negotiation position encompasses at least four tightening directions (*Fig. 2*): 1) Chinese equity restrictions: enterprises with greater than 25% Chinese ownership would be excluded from USMCA preferential tariff benefits, mirroring the OBBBA's Prohibited Foreign Entity (PFE) threshold; 2) RVC threshold increases: pushing non-automotive battery products toward automotive-equivalent RVC levels of 75% or higher, narrowing the arbitrage window available under the current 65%/55% structure; 3) battery cell "core component" designation: requiring cells to independently satisfy their own high RVC threshold; 3) a CFIUS-type (Committee on Foreign Investment in the United States) investment screening mechanism: the McCormick-Cortez Masto Act, introduced in the Congress, directs the USTR to advocate for a Committee on Foreign Investment in the United States (CFIUS)-equivalent framework within Mexico's investment review structure. This last mechanism faces the longest implementation timeline — Mexico currently has no foreign direct investment (FDI) screening law, and we estimate two to three years of domestic legislations before any such mechanism could be implemented.

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Implication: USMCA tightening further constrains the route

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For >25% Chinese ownership excluded from USMCA benefits: Chinese ESS firms with majority ownership cannot cure disqualification through supply chain restructuring alone — the remedy requires diluting equity below 25%. Thus, we believe this operationally impairs Chinese management control, and may trigger a Mexico divestment cycle mirroring the pattern already observed in Japan and Korea, where Chinese battery firms have broadly reduced stakes. **In terms of RVC threshold raised to 75%+:** With non-cell North American content capped at ~48% of total BESS system cost (*Fig. 3*), a 75% RVC threshold is likely to be unbridgeable without sourcing battery cells from North American producers — a supply constraint that will not ease materially until LGES' (373220 KS, Buy) LFP facility reaches volume production in 2027-28F. Chinese ESS assemblers in Mexico may need to absorb structurally higher costs by switching to NA-sourced cells, **Regarding the battery cell designated as "core component" subject to independent RVC test:** This is the most structurally damaging provision. By requiring cells to independently satisfy a 75% NA RVC threshold, the measure renders Chinese-manufactured cells categorically non-compliant regardless of the overall system cost mix, eliminating any engineering workaround available under standard RVC mechanics. Mexico's role as a re-export hub for Chinese battery technology is effectively severed absent full localisation of cell production in North America. **On the CFIUS-equivalent investment screening in Mexico**: The near-term investment implication is limited — Mexico has no existing FDI screening framework and the legislative runway is estimated at 2–3 years, meaning existing structures are unaffected. However, the longer-dated risk is material: once enacted, greenfield Chinese capital deployment into Mexican battery manufacturing would face a formal national security review layer, further eroding the investment case for Mexico as a USMCA-compliant production base, in our view.

Fig. 1: USMCA – key milestone dates

Date	Event	Details
Sep 16, 2025	USTR public comment period opened	Formally initiated the pre-review stakeholder consultation process under USMCA Article 34.7. Industry submissions signaled early US intent to tighten rules of origin (ROO) thresholds for battery and ESS supply chains with elevated Chinese content — the first formal signal that the review would extend beyond automotive into energy storage.
Jan 3, 2026	USTR report to Congress filed	Statutory reporting obligation fulfilled under 19 U.S.C. §4214(b). The report outlined US negotiating objectives for the USMCA review and explicitly flagged Chinese capital penetration into Mexican manufacturing — including battery and ESS supply chains — as a priority concern, establishing the policy framework that would drive subsequent bilateral talks.
Mar 5, 2026	US–Mexico bilateral review formally launched	Official USTR announcement (ustr.gov) confirming commencement of structured government-to-government talks. Critically, the launch confirmed the review's scope extends to non-automotive sectors, including battery energy storage systems (BESS) — a material departure from prior USMCA reviews that focused exclusively on automotive ROO. We view this as the moment the Mexico assembly arbitrage for Chinese ESS firms moved from theoretical risk to active policy target.
Mar 16, 2026	Regular negotiator-level meetings commenced	Technical-level working group talks initiated between USTR and Mexican counterparts, with dedicated workstreams covering: (1) ROO threshold increases for battery products, (2) Chinese equity restrictions mirroring the OBBBA PFE framework, and (3) investment screening mechanisms. The structured cadence of talks reinforced investor concern that substantive tightening — not merely procedural review — is the intended outcome.
Jul 1, 2026	**USMCA Free Trade Commission formal review — key decision point**	**The USMCA Joint Review Commission convenes to determine the agreement's future trajectory. We identify three scenarios: (1) clean 16-year extension with no renegotiation; (2) modified extension incorporating tighter ROO thresholds and Chinese equity restrictions, which would structurally impair the Mexico assembly route for Chinese ESS firms; (3) annual review mode — 'negative' for capital expenditure, as the commitment of a 2–3 year factory construction cycle against a 1-year policy horizon.**

Source: USTR, Nomura research

Fig. 2: Potential USMCA measures and the impact on Chinese ESS access

Potential policy measure	Implementation mechanism	Impact on Mexico-based supply chain
>25% Chinese beneficial ownership excluded from USMCA preferential tariff treatment	Mirrors OBBBA Prohibited Foreign Entity (PFE) threshold	Directly disqualifies Chinese-controlled entities from USMCA benefits regardless of assembly location; ownership restructuring required to retain market access
RVC threshold raised to 75%+	Applies automotive-equivalent NA content standard; non-cell NA content is ~35%, meaning the gap cannot be bridged without qualifying NA-sourced battery cells	Partial restriction — raises the compliance bar materially, but theoretically addressable through sourcing adjustments; significant cost headwind for Chinese OEMs reliant on domestic cell supply
Battery cell designated as "core component" subject to independent RVC test	Each battery cell must independently satisfy 75% NA RVC — mathematically unachievable using Chinese-manufactured cells under current production economics	Likely disqualify for Chinese cell suppliers; severs Mexico as a viable re-export hub for Chinese battery technology absent full localisation of cell production
CFIUS-equivalent inbound investment screening mechanism introduced in Mexico	Modelled on McCormick-Cortez Masto Act; Mexico currently has no FDI screening legislation — likely 2–3 year legislative runway required	Indirect impact in the near term; longer-dated risk to greenfield Chinese FDI into Mexico pending legislative outcome; does not affect existing structures in the short run

Source: Nomura estimates

Fig. 3: Battery energy storage system (Notice 2025-08)

Applicable Project Component	Manufactured Product Component	Grid-scale BESS
Battery Pack/Module	Cells	52.0%
	Packaging	5.6%
	Production	8.0%
Inverter / Converter	Printed Circuit Board Assemblies	1.4%
	Thermal Management System for Inverter	0.4%
	Electrical Parts	0.5%
	Enclosure & Skids	0.4%
	Production	1.9%
Battery Container / Housing	Enclosure & Skids	14.8%
	Battery Management System	7.4%
	Thermal Management System for Battery Container / Housing	5.6%
	Production	2.0%
Steel or iron reinforcing products in foundation		Steel/Iron Product
Total		**100.0%**

Source: Internal Revenue Service, Nomura research

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Appendix A-1

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