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Investment Protection under the USMCA Trade Deal – Substantial Changes in the Dispute Resolution Process under NAFTA

PART I. SUBSTANTIVE PROTECTION

INTRODUCTION

1. After long and intense negotiations, the United States, Mexico and Canada seem to have reached an agreement on a revisited text of the North American Free Trade Agreement ("NAFTA"). The new agreement has been named the United States, Mexico and Canada Agreement ("USMCA"). The proposed text substitutes Chapter 11 NAFTA on investment protection by introducing a new Chapter 14. Chapter 14 also contains an Annex 14-D which regulates the dispute settlement mechanism for investor-state controversies between the United States and Mexico.

2. In the following sections, the main changes implemented by the revisited text proposal on investment protection standards, as well as those concerning the dispute settlement mechanism, are introduced. Part I focuses on the substantive standards for protection whereas Part II addresses some key provisions of the dispute settlement mechanism. In general, although substantial revisions have been made to update the language, the USMCA is closer to an update of NAFTA than it is to a new trade agreement. The comments below are amongst the most significant changes to the original NAFTA language.

PART I. SUBSTANTIVE PROTECTION STANDARDS

3. Chapter 14 USMCA (denominated "Investment") maintains the essence of all investment protection standards contained in Chapter 11 NAFTA, albeit the content of most provisions suffered noteworthy changes. Following the drafting tradition of modern BITs and investment arbitration practice, the definitions of 'investment' and 'investor' as well as the content of key investment protection standards were detailed to a greater extent for legal certainty. The amendments are also strongly influenced by the wording of the 2004 US BIT Model.

Definition of 'Investment' and 'Investor'

4. Article 14.1 largely follows the definition of the term "investment" contained in the 2004 US BIT Model. Article 14.1 expressly expands the scope of the term to explicitly cover owned or controlled indirect investments while clarifying that generally accepted constitutive elements of an investment (i.e., the commitment of capital or other resources, the expectation of gain and profit, or the assumption of risk) are required.

5. Distinct from most BITs and the NAFTA, the USMCA now contains a list of assets that do not constitute an investment including: "*(i) an order or judgment entered in a judicial or administrative action*"; and (ii) claims to money deriving from contracts for the sale of goods or services - or from the extension of credit in connection with such contracts.

National Treatment and Most-Favored-Nation Treatment

6. Articles 14.4 and 14.5 USMCA regulate National Treatment ("NT") and Most-Favored-Nation Treatment ("MFN") standards, respectively.

7. First, a paragraph 4 was added in both articles. This paragraph provides that to analyze the requirement of "like circumstances" the totality of circumstances must be considered including "*whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives*". Therefore, it expressly provides that a distinction made on grounds of legitimate public welfare objectives can be justified.

Minimum Standard of Treatment

8. Article 14.6 of the USMCA regulates the Minimum Standard of Treatment and reflects substantial changes. First, instead of providing that "*Each Party shall accord to covered investments treatment in accordance with international law…*", the modified article refers to "*customary international law*". Therefore, it excludes other sources of public international law from the minimum standard, arguably such as the jurisprudence of international tribunals. The drafters of USMCA also included Annex 14-A which explains the State Parties' shared understanding of customary international law for purposes of Article 14.6. The USMCA therefore will likely lead to a more restricted and host state friendly interpretation of the fair and equitable treatment standard.

9. Article 15.6 further clarifies that neither the FET standard nor the FPS standard in the USMCA go beyond the minimum standard of treatment which states are obliged to accord under customary international law anyway.

10. Article 14.6(4) includes an interesting novelty stating that the fact that a state takes, or does not take, any action which is inconsistent with an investor's expectations does not constitute a breach of article 14.6. It therefore appears likely that this provision will greatly limit the standard of protection as it excludes the reasonable investment-backed expectations of investors from the scope of protection under the treaty. According to article 3 of Annex 14-B (further discussed below) such "distinct, reasonable investment-backed expectations" are now relevant only for deciding whether there has been an indirect expropriation. In practice, such expectations were frequently invoked by investors in the context of the violation of the fair and equitable treatment standard.

Expropriation and Compensation

11. Article 14.8 USMCA together with Annex 14-B contains the rules on expropriation and compensation. These rules are far more detailed than the equivalent provision in Chapter 11.[1] In particular, Annex 14-B defines the different types of expropriation. First, it addresses direct expropriation, i.e. the formal transfer of property title from the investor. Second, the Annex also sets out the factors for assessing whether there has been indirect or creeping expropriation. It provides that the following factors shall be considered with respect to whether indirect expropriation has taken place: (i) the economic impact of the measure; (ii) the extent to which the measure interferes with reasonable investment-backed expectations; and (iii) the character of the measure, including its object, context and the government's intent.

12. It also attempts to balance the investor's protected rights with the state's regulatory right by providing that non-discriminatory regulatory measures designed and applied to protect legitimate public welfare objectives do not constitute indirect expropriation, except in rare circumstances. In particular, the Annex spells out that the economic impact on the investment by and for itself is insufficient for an expropriation.

13. Article 14.8 mirrors Article 6 of the 2004 US Model BIT. Compared to Article 1110 Chapter 11, it incorporates the Hull Formula "*prompt, adequate and effective*" to the requirement of compensation.

14. Article 14.8 eliminates the illustrative criteria to calculate the fair market value contained in Article 1110.

15. Finally, regarding the currency used for determining compensation, Article 14.8 uses the term "freely usable currency" as determined by the International Monetary Fund[2] instead of the term "G7 currency" which referred to the currency of Canada, France, Germany, Italy, Japan, the United Kingdom of Great Britain and Northern Ireland or the United States.

PART II. DISPUTE SETTLEMENT MECHANISM

16. The possibility of enforcing rights granted to investors in a treaty is, of course, of particular significance. Both NAFTA and the USMCA, contain a mechanism through

[1] See Article 1110 NAFTA.

[2] Article XXX (f) of the IMF Articles of Agreement defines "freely usable currency" as "*a member's currency that the Fund determines (i) is, in fact, widely used to make payments for international transactions, and (ii) is widely traded in the principal exchange markets*." IMF Articles of Agreement adopted at the United Nations Monetary and Financial Conference, Bretton Woods, New Hampshire, July 22, 1944, amended effective January 26, 2016 by the modifications approved by the Board of Governors in Resolution No. 66-2, adopted December 15, 2010.

which investors can arbitrate disputes with state parties. The USMCA, however, brings several significant changes to this system

Disputes involving investments to or from Canada

17. The USMCA does not provide for arbitration of disputes between US or Mexican investors, on the one hand, and Canada, on the other hand (or between Canadian investors and the US or Mexico). Annex 14-C, however, stipulates that disputes deriving from so-called legacy investments, i.e. an investment established or acquired before the termination of NAFTA and still in existence when USMCA enters into force, can be arbitrated under the rules set out in chapter 11 of NAFTA. Hence, any dispute arising from an existing investment is not left completely without protection though it should be noted that there is a sunset provision limiting the time in which to commence such proceedings.

Mexico – United States Investment Disputes

18. As to arbitrating disputes between investors and Mexico or the United States, the USMCA incorporates substantial changes. The key changes contained in Annex 14-D of Chapter 14 are:

Consent to Arbitration and its Limitations

19. Article 1122 of NAFTA and Article 4 of Annex 14-D of USMCA define consent to arbitration. There has been no change in the language between the two articles. However, Article 5 of Annex 14-D of USMCA stipulates the "Conditions and Limitations on Consent." That article restricts the submission of claims to arbitration by requiring that: (i) a claimant "first initiated a proceeding before a competent court or administrative tribunal of the respondent with respect to the measures alleged to constitute a breach," (ii) the claimant has a final decision "from a court of last resort" or it has been more than 30 months since the court action has been initiated; (iii) the claimant consent in writing to arbitration; and (iv) the notice of arbitration contains the claimant's written waiver of any right to bring the claim in any other forum. This provision therefore re-introduces the requirement of the exhaustion of local remedies, which actually had long been abolished in investment arbitration.

20. This is in addition to the language in Article 2 of Annex 14-D that parrots 1118 NAFTA noting that "parties should first attempt to settle a claim through consultation or negotiation." This greatly restricts the ability of claimants to bring a claim under this dispute resolution mechanism and prohibits parties from using this system as the primary attempt at dispute resolution. The USMCA thus yields a three-step process of attempted consultation followed by court action followed by arbitration.

Selection of Arbitrators

21. Article 6 of the USMCA reduces the time limit after which the Secretary-General (of ICSID) can appoint an arbitrator, if the parties have not done so, from 90 to 75 days. Additionally, it removes the provision of 1124(4) of NAFTA which required the State Parties to establish and maintain a list of 45 presiding arbitrators ("experience in international law and investment matters") from which the Secretary-General was to pick a presiding arbitrator. Under the USMCA, the Secretary General makes the appointments "in his or her discretion" which accordingly provides substantially more flexibility.

22. Article 6(5)(c) may in practice limit the freedom of parties to choose arbitrators quite considerably. According to this provision, arbitrators shall "refrain, for the duration of the proceedings, from acting as counsel or as party-appointed expert or witness in any pending arbitration under the annexes to this Chapter." Hence, the pool of available arbitrators will likely be limited somewhat.

Conduct of the Arbitration

23. Provisions concerning the conduct during the proceedings were previously covered by individual sections but have now been consolidated and amended into Article 7 of Annex 14-D. The new and improved procedure permits for interested third parties to submit amicus curiae briefs and allows for disputing parties to respond to such submissions. This again, is a step in increasing the transparency in these proceedings and allowing interested third parties' involvement.

24. Further, Article 7 has added detail of the procedure of the tribunal addressing objections that as a matter of law a claim submitted is not a claim for which an award in favor of the claimant may be made, or that a claim is manifestly without legal merit, as preliminary questions. The article also permits for expedited preliminary questions if they are raised within 45 days after the tribunal is constituted, as well as awarding costs and attorney's fees to the prevailing party.

25. Finally, the article provides for a timeline within which parties must take steps to further the proceedings or else risk a discontinuance of the dispute and allows for a 60 days comment period for parties concerning any aspect of the proposed decision or award.

Transparency of Arbitral Proceedings

26. A major noteworthy addition is Article 8, which makes a very clear attempt at enhanced transparency for the dispute resolution process. Article 8 requires the respondent of a USMCA dispute resolution to promptly make available to the public "(a) the notice of

intent; (b) the notice of arbitration; (c) pleadings, memorials and brief submitted to the tribunal by a disputing party and any written submissions submitted pursuant to Article 7.2 (Conduct of the Arbitration) and Article 7.3 and Article 12 (Consolidation); (d) minutes of transcripts of hearings of the tribunal, if available; and (e) orders, awards and decisions of the tribunal." Further, the article requires the hearings to be open to the public, however, still allowing for exclusion of protected information.

27. The addition of the explicit possibility of public hearings may help counter a major point of criticism the NAFTA dispute resolution mechanism has received and will enable the public to become more knowledgeable about the disputes that arise under the highly sophisticated trade deals conducted between the signatory countries.

Awards

28. Article 13 has, like many of the clauses been revamped and additional detail has been added. Although the types of awards have not changed, they still prohibit punitive damages, the tribunal may now allocate reasonable costs and attorney's fees and by whom they should be paid. The enforcement of the final award has not changed, and awards made by the tribunal continue to be binding solely on the disputing parties in the particular case.

This article is not legal advice and is generic in nature, if you would like to discuss anything arising from this commentary please contact:

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