What’s in a Name Change? For Investment Claims Under the New USMCA Instead of NAFTA, (Nearly) Everything.

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President Trump’s October 1, 2018 announcement that the United States, Canada, and Mexico have reached an agreement to replace the 1994 North American Free Trade Agreement (NAFTA) marks a veritable sea change in investor-state dispute settlement in the region. Previous and prospective users of NAFTA’s dispute resolution procedures will immediately note that this new free-trade agreement departs substantively and significantly from the NAFTA’s investment chapter—which has been on the books since 1994. More than just a change in name, the new United States-Mexico-Canada Agreement (USMCA), is an identity change.

This brief note discusses preliminary impressions from the released text of the USMCA and addresses only the investor-state arbitration provisions in USMCA, Chapter 14, that purport to replace Chapter 11 of the NAFTA. It begins with a discussion of the implications for those with cases already before NAFTA tribunals, then moves to the relevant considerations for investors in Canada and Mexico, and then presents some key definitional changes in the new text. The note concludes with some initial takeaways and a watchlist for readers while the USMCA Parties

await U.S. Congressional approval. This note is far from comprehensive – no doubt, the applicability, interpretation, and application of the USMCA's provisions will be the subject of increased discussion and scrutiny in the coming months.

Part I

For now, the USMCA is not yet the law of the land in the United States – as with any U.S. treaty, it must first be approved by Congress. Nonetheless, there are (at least) three key takeaways at this initial stage:

1. Under this proposed USMCA text, current NAFTA litigants need not fear that the USMCA will disrupt ongoing NAFTA arbitrations (i.e., the shift to the USMCA will have no effect on the fourteen cases that have already been filed under Chapter 11 of the NAFTA).

2. Although the NAFTA has not yet been terminated, the USMCA provides that, once terminated, investors may nevertheless file NAFTA claims within *three years*, provided the investments were validly made in accordance with Chapter 11 of the NAFTA already (or are made during the short remaining interval while NAFTA is still in force).

3. The USMCA would completely eliminate future investor-state arbitration between U.S. and Canadian parties under the USMCA. Moreover, the USMCA would limit the type of disputes that may be brought by investors of investments made between the United States and Mexico, and would force investors to file claims in national courts first, and then wait 30 months before initiating arbitration (unless the investor has a contract with the government relating to an "covered sector" expressly specified in the USMCA).

Thus, investors with existing investments covered by the NAFTA who wish to bring arbitration against Canada pursuant to Chapter 11 of NAFTA would need to do so within three years of the NAFTA's termination if the USMCA is approved by Congress and the NAFTA is terminated, or otherwise risk losing their ability to file investor-state arbitration under the new USMCA altogether. Investors with qualified investments in Mexico may still have the option to bring an investor-state arbitration under the USMCA after filing a claim in national courts and waiting the requisite 30 months after initiating that lawsuit, but would do well to confirm whether their potential investment claims are part of a covered sector under the USMCA (thereby enabling them to take advantage of the full remedies available

under the USMCA), or if they will be limited in the types of claims they can file.

No change for current litigants of NAFTA claims, but claims for investments established or acquired while NAFTA is in force must be brought within three years of NAFTA's termination.

For those parties with arbitrations that have already been filed under Chapter 11 of the NAFTA, the current text of the USMCA would allow these NAFTA arbitrations to proceed uninhibited. Moreover, Annex 14-C of the USMCA, pertaining to "Legacy Investment Claims and Pending Claims," directly addresses whether (and in which circumstances) prospective claims might be "grandfathered" into the NAFTA's existing investment protection regime.

A "legacy investment" is defined in Article 6(a) of Annex 14-C as "an investment of an investor of another Party in the territory of the Party **established or acquired between January 1, 1994, and the date of termination of NAFTA 1994, and in existence on the date of entry of force of this agreement**." Accordingly, an investment must have been "established or acquired" when the NAFTA is still in force, and remain "in existence" on the date of the USMCA's entry into force.

As users of investment arbitration are no doubt familiar, a State must express its consent to arbitrate investment claims against an investor from another State. In the context of the "legacy investments" discussed above, the new USMCA makes clear that an investor cannot wait to file its NAFTA claims ad infinitum. Rather, each State Party's consent to arbitrate in accordance with Section B of Chapter 11 of the NAFTA expires "three years after the termination of NAFTA 1994," under Article 3 of Annex 14-C.[fn] Notably, under Article 2 of Annex 14-C, the consent and submission to arbitration must "satisfy the requirements" of Chapter II of the ICSID Convention.[/fn]

Chapter 14 also provides that "an arbitration initiated pursuant to the submission of a claim under Section B of NAFTA 1994 while NAFTA 1994 is in force may proceed to its conclusion […] the tribunal's jurisdiction with respect to such a claim is not affected by the termination of NAFTA 1994." Thus, Annex 14-C clarifies that the USMCA creates no jurisdictional impediment to the completion of already-filed NAFTA claims.

No investment claims for future U.S. investors in Canada (or vice-versa)

after the NAFTA's Termination.

The USMCA's current text eliminates the possibility of future investor-state arbitration between U.S. and Canadian parties under the USMCA for investments made after the termination of the NAFTA.[fn] Although investor-state arbitration is dead between the U.S. and Canada, state-to-state arbitration between the two very much survives. Canada won its fight over NAFTA Chapter 19, paying for it in dairy concessions, and there will be no change to those provisions. This means that Canada may continue to bring suit before a special panel over alleged unfair trade practices by the U.S. and Mexico, including anti-dumping and countervailing duties.[/fn] This is unequivocal in the text of Article 14.2 of the USMCA, which limits the scope of investor-state arbitration to Legacy Investment Claims and Pending Claims, Mexico-U.S. Investment Disputes, and Mexico-U.S. Investment Disputes Related to Government Contracts only:

> *For greater certainty, an investor may only submit a claim to arbitration under this Chapter as provided under Annex 14-C (Legacy Investment Claims and Pending Claims), Annex 14-D (Mexico-United States Investment Disputes), or Annex 14-E (Mexico-United States Investment Disputes Related to Covered Government Contracts).*

Investors wishing to arbitrate claims will be forced to arbitrate in a forum other than a NAFTA investment tribunal (likely pursuant to a contract or other applicable instrument containing a valid arbitration clause), or be forced to bring claims in local courts if a domestic remedy is available.

The USMCA imposes limits on investment arbitration for U.S. investors in Mexico (or vice-versa).

Although not as clear-cut as the prohibition on claims of U.S. investors against Canada (or vice-versa), the new USMCA provisions would substantially limit the availability of investor-state dispute settlement for claims pertaining to investments made by U.S. investors in Mexico (and vice-versa).

Investor-state arbitration for U.S.-Mexico investment claims survives under Annex 14-D, but only as to claims of direct expropriation,[fn] Direct expropriation under Annex 14-B, Clause 2 occurs when "an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure."[/fn]

claims for violations of national treatment,[fn] USMCA Article 14.4.1 defines national treatment as “treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.”[/fn] or for violations of the most-favored-nation (MFN) provision of the USMCA[fn] Under the USMCA Article 14.5.1, most-favored-nation claims arise when a state’s treatment of an investor is “less favorable than the treatment it accords, in like circumstances, to investors of any other Party or of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.” Readers of the new USMCA will be particularly careful to read footnote 22 in Chapter 14, which provides that “the ‘treatment’ referred to in Article 14.5 (Most-Favored-Nation Treatment) **excludes provisions in other international trade or investment agreements that establish international dispute resolution procedures or impose substantive obligations; rather, ‘treatment’ only includes measures adopted or maintained by the other Annex Party**, which may include measures adopted or maintained pursuant to or consistent with substantive obligations in other international trade or investment agreements.” (emphases added) Like other provisions in Chapter 14 of the USMCA, the language of this provision may depart substantially from the definitions used in other investment agreements. [/fn] (except for any MFN or national treatment claims “with respect to the establishment or acquisition of an investment,” which are expressly excluded).

An exception to the above limitation is found in Annex 14-E of Chapter 14, entitled “Mexico-United States Investment Disputes Related to Covered Government Contracts.” As the title of the annex suggests, Annex 14-E does not apply unless the claimant is “a party to a covered government contract”[fn] Article 6 of Annex 14-E defines “covered government contract” as “a written agreement between a national authority of an Annex Party and a covered investment or investor of the other Annex Party, on which the covered investment or investor relies in establishing or acquiring a covered investment other than the written agreement itself, that grants rights to the covered investment or investor in a covered sector.”[/fn] that grants rights in a “covered sector” expressly named in Article 6 of Annex 14-E, in which case a claimant may rely on other benefits in the treaty, including the possibility of bringing claims for violations of the minimum standard of treatment afforded under customary international law,[fn] The USMCA defines

the minimum standards of treatment due to investors "in accordance with customary international law, including fair and equitable treatment and full protection and security." (Article 14.6.1). It adds that "(a) "fair and equitable treatment" includes the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world; and (b) "full protection and security" requires each Party to provide the level of police protection required under customary international law." (Article 14.6.2(a),(b))[/fn] claims of indirect expropriation,[fn] Indirect expropriation refers to a situation "in which an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure." (Annex 14-B, Clause 3)[/fn] or claims with respect to the establishment of acquisition of an investment. The five "covered sectors" are:

> *(i)* ***activities with respect to oil and natural gas*** *that a national authority of an Annex Party controls, such as exploration, extraction, refining, transportation, distribution, or sale;*
> *(ii) the supply of* ***power generation*** *services to the public on behalf of an Annex Party;*
> *(iii) the supply of* ***telecommunications*** *services to the public on behalf of an Annex Party;*
> *(iv) the supply of* ***transportation*** *services to the public on behalf of an Annex Party; or*
> *(v) the ownership or management of* ***infrastructure****, such as roads, railways, bridges, canals, or dams, that are not for the exclusive or predominant use and benefit of the government of an Annex Party.[fn] See Article 6 of Annex 14-E (emphases added). It should be noted that the preservation of investor-state arbitration in these key sectors is likely due to successful lobbying by American industry groups during negotiations.*

[/fn]

The USMCA also adopts *fundamental* procedural changes for all remaining US/Mexico claims submitted to arbitration, even those in the covered sectors. Prospective claimants and their counsel will need to carefully plan a litigation strategy to comply with preconditions to arbitration under Annex 14-D.

1. Prior to initiating investor-state arbitration under the USMCA, under Article 5 of Annex 14-D, U.S. and Mexican claimants *must* file suit in national courts. The dispute may proceed to arbitration only after "30 months have elapsed from the date the proceeding [in national courts] was initiated," or after a final decision has been rendered in the national court of last resort (e.g., in the case of the United States, the U.S. Supreme Court). Recourse to national courts is not required where it would be "obviously futile or manifestly ineffective" – but it remains to be seen how national courts (or USMCA tribunals) will interpret this provision.

2. Appendix 3 of the USMCA also provides that U.S. investors "may not submit to arbitration a claim that Mexico has breached an obligation under this Chapter[…] if the investor or the enterprise, respectively, has alleged that breach of an obligation under this Chapter in proceedings before a court or administrative tribunal of Mexico." Investors will likely question how Appendix 3 will be interpreted in light of Article 5 of Annex 14-D.

3. Moreover, *arbitration* under the USMCA must be filed within four years (i.e. 48 months) of the alleged breach by the claimant under Article 5 of Annex 14-D. As a practical matter therefore, assuming that a final decision in the national court of last resort has not been rendered prior to the 30 month waiting period, and assuming that the investor had filed suit in national court immediately after "the claimant first acquired, or should have first acquired, knowledge of the breach alleged … **and** knowledge that the claimant … or enterprise … has incurred loss or damage," parties will have only 18 months (at most) to file their claims – roughly half of the time previously permitted under Chapter 11 of the NAFTA.

4. Importantly, where the claimant is party to a "covered government contract" under Annex 14-E, i.e., investors contracting with a government to provide services in one of the five "covered sectors," the national courts requirement is waived[fn] See Footnote 31 to USMCA Chapter 14: "For greater certainty, Article 5.1(a)-(c) of Annex 14-D do not apply to claims under paragraph 2 [of Annex 14-E]."[/fn] and claimant may file anytime within a 3-year window. This means that – under the current USMCA text – those contracting with the government with respect to oil and gas activities, power generation, telecommunications, transportation, and infrastructure may not need to file in national courts first.

Regarding arbitrators, the USMCA explicitly adopts the IBA Guidelines on Conflicts of Interest in International Arbitration, including the guidelines on direct and

indirect conflicts of interest, and any supplemental guidelines, in Article 6.5 of Annex 14-D. It also imposes a so-called "two-hats" bar, prohibiting arbitrators from "acting as counsel or as party appointed expert or witness in any pending arbitration under the annexes to this Chapter."

Canada-Mexico investment arbitration might survive elsewhere, but not under the USMCA

Because no consent for investment arbitration has been included in the USMCA for investments between Canada and Mexico, investors seeking to bring investment claims are likely to rely on the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) rather than the USMCA. The CPTPP, to which both Canada and Mexico are signatories, offers many of the same protections accorded to investors under both the NAFTA and the USMCA.[fn] Comprehensive and Progressive Agreement for Trans-Pacific Partnership, Article 9: Investment[/fn] Mexico has already ratified the CPTPP and Canada has pledged to do so.[fn] "Canada Move Closer to CPTPP Ratification, Malaysia Calls for Trade Deal Review", International Centre for Trade and Sustainable Development (Jun. 28, 2018) [/fn] The CPTPP will enter into force after 6 of the 11 signatory countries complete their ratification processes.

Part II

The USMCA uses lessons learned from NAFTA to clarify legal terms and amend arbitral procedure

Incorporating lessons from past NAFTA arbitrations, the USMCA Parties took steps to clarify certain key terms (including the standards of investment protection) throughout the agreement, often in footnotes, which may prove relevant in the USMCA's interpretation. Some important changes are noted below:

1. Under the national treatment and most-favored-nation provisions of the USMCA, tribunals would be required to determine whether treatment is accorded in "like circumstances" based on a totality-of-the-circumstances test: "For greater certainty, whether treatment is accorded in "like circumstances" under this Article depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives."

2. The USMCA offers more guidance on the definition of an "investment," stating that "investment means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk."

3. In determining whether an "indirect expropriation" occurred within the meaning of Article 14.8.1 (as defined in Annex 14-B), the USMCA expressly states that this "requires a case-by-case, fact-based inquiry." (It should be recalled that, under the current USMCA text, only claimants with a "covered government contract" in one of five "covered sectors" may file a claim for breach of the USMCA, Article 14.8.1, for an indirect expropriation).

a. Annex 14-B instructs tribunals to consider "the economic impact of the government action" (though economic impact alone is not determinative), "the character of the government action, including its object, context, and intent," and "the extent to which the government action interferes with distinct, reasonable investment-backed expectations."

b. Regarding "reasonable, investment-backed expectations," it offers the following factors as guidance: "whether the government provided the investor with binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector."

4. In contrast to the USMCA's above definition of "indirect expropriation," the USMCA specifically rejects that the "minimum standard of treatment under customary international law" should be defined by reference to an investor's legitimate, investment-backed expectations. Specifically, Article 14.6(4) provides that "[f]or greater certainty, the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor's expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result." This departs from investment tribunals' interpretation of the fair and equitable treatment standard under other investment treaties, or (some argue) the minimum standard of treatment under customary international law.

Codifying the interpretation from the NAFTA's Free Trade Commission's trilateral "Notes of Interpretation of Certain Chapter 11 Provisions" from 2001,[fn] NAFTA Free Trade Commission, "Notes of Interpretation of Certain Chapter 11 Provisions"

(2001) (1. “Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party. 2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.”)[/fn] Article 14.6(2) of the USMCA specifies that the term “minimum standard of treatment” is the customary international law standard, stating “[f]or greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment”[fn] Article 14.6(2)(a) defines “fair and equitable treatment” as “includ[ing] the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.” [/fn] and “full protection and security”[fn] Article 14.6(2)(b) defines “full protection and security” as “requi[ring] each Party to provide the level of police protection required under customary international law.”[/fn] do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights.”

Things to watch

As current and prospective investors await congressional approval for the USMCA and the termination of the NAFTA, it might be asked: what happens next? The USMCA has created uncertainty for North American investors, which is likely to affect future foreign investment flows and raise new legal issues. Prudent investors and practitioners will watch for the following developments in the coming months:

• Will NAFTA officially be terminated, and if so, when? What date will the USMCA come into force?

• What are the likely issues that will emerge during the congressional approval process? How will industries respond to these changes, and what effect will their voices have on the USMCA’s approval? Will there be any proposed changes to the text of Chapter 14 of the USMCA?

• Will the CPTPP be ratified before the NAFTA’s termination, and will it really offer Canadian and Mexican investors an effective avenue for future investor-state

arbitration?

• Finally, in light of well-known developments in Europe pertaining to investor-state arbitration,[fn] See, e.g., Laurens Ankersmit, “Achmea: the Beginning of the End for INVESTOR-STATE ARBITRATION in and with Europe?”, Investment Treaty News, International Institute for Sustainable Development (Apr. 24, 2018).[/fn] is the USMCA part of a global trend away from investor-state arbitration?

Given this uncertainty, current and prospective investors may consider whether certain investments may be structured (or restructured) through effective nationality planning. Investors should consult qualified counsel to discuss investment-protection alternatives to the new USMCA, including analysis of investment treaties between USMCA Parties and other States. These other investment treaties may contain more favorable standards of investment protection (or more advantageous procedural provisions) than those in the proposed USMCA text.