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USMCA: An Analysis of the Proposed ISDS Mechanism

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Introduction

The United States, Mexico, and Canada renegotiated the 25-year-old North American Free Trade Agreement (NAFTA) in 2018. As a result of these renegotiations, the parties agreed on new terms to formulate "NAFTA 2.0" or the U.S.-Mexico-Canada Agreement (USMCA) in the United States, the CUSMA in Canada and, the T-MEC in Mexico.

The USMCA aims to strengthen networks of trade, decrease investment barriers, and facilitate commercial exchanges. The USMCA needs to be ratified by each country's legislature before it can become effective. Mexico ratified the USMCA in June 2019 after Mexico's senate voted overwhelmingly in its favor. Keeping in mind that USMCA will replace NAFTA, investors who invested in another member's territory between the date NAFTA came into force and the date of termination of NAFTA may still utilize arbitration in accordance with the NAFTA's Investor State Dispute Settlement provisions for three years after the termination of NAFTA. The arbitration proceedings which have already begun will be concluded under NAFTA Chapter 1.

Despite the proposed changes, the essence of USMCA remains the same and it is intended that it will continue to serve the purpose that the NAFTA was formulated for. The new investor-state dispute settlement (ISDS) mechanism at Chapter 14 of the USMCA has seen a major overhaul. This post discusses the proposed changes to the ISDS mechanism.

Changes to the Investor State Dispute Settlement System

Definition of Investment

The USMCA defines 'investment' as an asset that an investor owns or controls that has the characteristics of an investment such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. This definition is more descriptive and of a wider scope than the one provided under NAFTA. In *Apotex Inc. v. The Government of the United States of America*, the NAFTA Tribunal held that significant expenses incurred in: (i) seeking Food and Drug Administration ("FDA")

approval; (ii) purchasing materials and ingredients in the United States intended for the manufacture of products abroad (in this case in Canada); and (iii) conducting litigation and establishing an agent in the United States for the purpose of corresponding with and making submissions to the FDA, were all insufficient to qualify as an "investment" under the treaty. There have been different awards interpreting whether the 'investment' falls within the scope of NAFTA and this was one of those which confirmed a NAFTA tribunal may require higher thresholds to bring claims under the agreement.

Parties

One of the most important changes in the proposed agreement is Canada's withdrawal from the dispute resolution regime as existed under the NAFTA. Under the USMCA, the three parties will only be able to bring claims against each other arising out of unfair trade practices. Apart from that limited exception, the ISDS regime shall be limited to the United States and Mexico. Canadian and Mexican investors will, however, be able to rely on their rights under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), which are similar to rights generally available in North American bilateral investment treaties.

Claims

NAFTA was the first regional trade agreement to include more extensive investor rights and included indirect expropriation. The USMCA, however, provides more restrictive standards for investors to bring claims than before. It includes a four-year statute of limitations for bringing claims and this period includes a mandatory 30 months of litigation in domestic courts albeit only to the extent recourse to domestic remedies was obviously futile or manifestly ineffective.

- Minimum Standard of Treatment

USMCA has the same standard as provided under the NAFTA. It, however, clearly states that 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond the minimum standard of treatment under customary international law. This is in consonance with the binding interpretation of this provision issued by the NAFTA Free Trade Commission in July 2001. The tribunals in *Metalclad Corporation v. The United Mexican States*, *S.D. Myers Inc. v. Canada*, and *Pope and Talbot Inc. v. Government of Canada*, proceeded on the basis that a breach of the standard can be found for acts that would not be found to have breach the minimum standard treatment at customary international law. It also mentions that an action would not be a breach of the minimum standard of treatment merely because it did not meet the investor's expectations.

- Expropriation

The USMCA proposes that the expropriation provision will be qualified by a detailed shared understanding of expropriation requiring specific factors to be considered in determining whether an action may constitute either direct or indirect expropriation.

Non-discriminatory regulatory taking, aimed at protecting public welfare objectives, shall not be considered to be indirect expropriation within the scope of the agreement, subject to certain exceptions. Under NAFTA, the provision led to differences in interpretation between tribunals owing to an unclear definition. For instance, in the case of *Pope & Talbot, Inc. v. Canada*, the tribunal had observed that the test for indirect expropriation was whether the interference was sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner. In *Metalclad Corp. v. United Mexican States*, however, the tribunal had held that the finding of indirect expropriation depended on a party's reliance on federal governmental representations, the nature of the measures taken by the local government, and the economically harmful effects of those measures. The new agreement seeks to prevent differences in the interpretation of provisions by tribunals.

- Most Favored Nation and National treatment

National treatment and MFN treatment claims shall not be permitted for investments at their establishment or acquisition stage. The National Treatment and Most Favored Nation Treatment provisions include a "public welfare" criterion to situate the "like circumstances" analysis. Thus, in considering whether the relevant treatment is accorded in "like circumstances," consideration must now be given to whether the treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives.

Special regime

A special regime and enhanced ISDS protections have been granted to investment in government contracts in "covered sectors." Covered sectors include oil and gas, power generation, telecommunications, transportation, and infrastructure. This has been developed to protect industries that are heavily regulated and may be influenced by the presence of state-owned enterprises. Disputes under government contracts do not mandate a waiting period of 30 months prior to the commencement of arbitration.

Procedural Aspects

The USMCA includes updated provisions for transparency of arbitral proceedings, with regards to public hearings and public access to documents. Arbitrators appointed to a tribunal to determine claims submitted under the agreement are required to comply with the International Bar Association Guidelines on Conflicts of Interest in

International Arbitration, including guidelines regarding direct or indirect conflicts of interest, or any supplemental guidelines or rules adopted by the U.S. and Mexico. Further, in an apparent effort to improve transparency in the decision making process, arbitrators are not permitted to act as counsel or as party-appointed expert or witness in any pending arbitration under the agreement for the duration of the proceedings in which they have been appointed. The agreement also includes new rules for selection of arbitrators.

Comments by State representatives

Since the agreement was signed on November 30 last year, it has been criticised and praised almost equally. Canadian Prime Minister Justin Trudeau tweeted after a conversation with his US counterpart that USMCA will "enhance competitiveness & prosperity, while creating new jobs". Mexican President Enrique Pena Nieto dubbed the deal a "win-win-win" agreement. US President Donald Trump tweeted: "The USMCA is a historic transaction!" In a joint statement, US Trade Representative Robert Lighthizer and Canadian Foreign Minister Chrystia Freeland hailed USMCA as a "modernised" agreement that "will strengthen the middle class, and create good, well-paying jobs". Mexican Economy Secretary Ildefonso Guajardo called it "a state-of-the-art instrument that will bring great economic benefits to Mexico, Canada and the US".

Conclusion

While the negotiations were the focus of attention for the terms to be agreed upon by all nations and the heated discussions to reach a consensus, ratification of the agreement by the U.S. Congress is under the limelight again. The Democrats have indicated concerns regarding the agreement and asked for stronger labor, environmental protection, and enforcement provisions under the USMCA. Canada is currently holding off on a formal vote until the agreement has been ratified by the U.S. Congress.

It remains to be seen if less claims arise due to the restrictive ISDS mechanism now proposed under Chapter 14 of the USMCA. For now, to test the waters on the narrower provisions, the immediate requirement is for the United States government to ratify the agreement, which will most likely be followed by ratification by the Canadian government. With the Canadian national elections which took place on 21 October 2019 and Canada promising to follow suit after the American government passes the agreement, the future of the USMCA can only be speculated upon at this stage.

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