The USMCA/CUSMA/T-MEC's Entry into Force: USMCA and U.S. Investors – A Reversal of Fortune?

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The Investment Chapter of the United States-Mexico-Canada Agreement "USMCA," Chapter 14 has had a controversial trajectory. Chapter 14 reflects a remarkable evolution in United States ("U.S.") policy on the protection of its investors and their investments in Canada and Mexico. It is remarkable because – from 2023 – it will limit the scope of protected investors, and will also prioritize some investors over others. In short, it is a reversal of U.S. investment protection policy as outlined in the NAFTA, and even in post-NAFTA agreements. Nonetheless, given the rhetoric from the Trump Administration over the last three years to the effect of eliminating investment protection, its mere existence is remarkable. Ultimately, it reminds, or informs, beneficiaries that the grant of investment protection is a political decision made in the context of larger political and economic considerations. In this post, I focus on what the new landscape will look like for U.S. investors in Canada and Mexico, and offer some perspective on the balance struck in Chapter 14.

The USMCA's Substantive Investment Protections Track Those in Post-NAFTA Treaties

Unlike investment chapters in recent U.S. free trade agreements ("FTAs") and the

U.S. Model bilateral investment treaty, the USMCA sets up a tiered system of investment protection. Chapter 14 begins with a section outlining the substantive provisions (normally "section A" of investment chapters). As is normal, the substantive obligations are set out after the preliminary provisions (Definitions, Scope and Relation to Other Chapters). The National Treatment ("NT"), Most Favored Nation ("MFN"), and Minimum Standard of Treatment ("MST") provisions (14.4-14.6) all reflect iterations found in recent U.S. agreements. For example, the NT and MFN obligations explain that the "in like circumstances" limitation on the obligation to provide such treatment requires a "totality of the circumstances" analysis, including whether any different treatment of investors is due to legitimate public welfare objectives. Similarly, the MST provision is the post-NAFTA iteration, anchored in customary international law (Annex 14-A), and includes the notice to tribunals that the obligation generally does not cover breaches of an investor's expectations (*See* 14.6.4).

Further, the Expropriation and Compensation provision is linked to the modern explanatory annex that requires tribunals considering indirect expropriation claims to understand that non-discriminatory regulatory actions designed to further legitimate public welfare objectives are not, except in rare circumstances, violations (*See* Annex 14-B). In addition to the other standard provisions, Article 14.17 "Corporate Social Responsibility" also reflects the latest U.S. thinking. This provision is aspirational and directs the Parties to encourage enterprises in their territory to "voluntarily incorporate" various international principles, standards, and guidelines.

USMCA's Innovations with Respect to Investor-State Dispute Settlement

The above substantive standards of protection are the largely non-controversial modernizing elements of Chapter 14. From there, things get interesting. Chapter 14 is divided into Annexes that explain which investors can bring claims and when. In essence, the USMCA provides different access to dispute settlement to certain investors. Under the tiered protection structure of the Chapter, the drafters first included a "tail" (which did not exist in NAFTA 1994) – Annex 14-C – denominated "Legacy Investment Claims and Pending Claims." So, investors – Canadian, Mexican, U.S. – are permitted to bring claims under the provisions of existing NAFTA 1994 Chapter 11 Section B for three years after NAFTA is

terminated for investments made during the life of NAFTA (*See* Annex 14-C, 14.1-14.4).

In the next tier is the first of two annexes that apply only to Mexican and U.S. investors for claims arising out of investments made after the USMCA goes into effect. The annex limits claims to NT, MFN (post-establishment), and direct expropriation violations. There are a few things to highlight about Annex 14-D. First, the lightning rods of NAFTA investment arbitration – the MST standard and indirect expropriation – do not feature (*See* Annex 14-D, article 14.D.3). In addition, a hallmark of U.S. investment protection policy – pre-establishment protection – is no more (*See* Article 14.2.3 and Annex 14.D.3.1(a)). Annex 14-D also incorporates the now standard U.S. position that MFN does not apply to dispute resolution provisions (*See* footnote 22).

Addressing another controversial feature of NAFTA investment arbitration, Annex 14-D requires that local remedies be exhausted for a period of at least 30 months, subject to an open-ended futility exception (*See* Annex 14.D.5.1(a),(b) and footnote 25). Notwithstanding, investors are also required to submit waivers of the right to initiate or continue litigation along with their notice of arbitration (Annex 14.D.5.1(e)). Furthermore, Appendix 3 prohibits U.S. investors from submitting claims based on the USMCA if they have already been submitted to Mexican courts. Finally, Appendix 2 excludes investment arbitration related to public debt disputes (a feature of recent U.S. FTAs). Annex 14-D also incorporates now standard U.S. provisions regarding the conduct of arbitral proceedings, including *amicus curiae* and non-disputing party submissions, expedited preliminary question proceedings, costs for frivolous claims, transparency measures, and the role of the Free Trade Commission in interpreting the agreement's commitments (*See* 14.D.7 and 14.D.8, 14.D.9, 14.D.10). The USMCA also seeks to address concerns regarding tribunals' damages awards. In Article 14.D.13.1.2 there is a directive that "satisfactory evidence," that is not speculative, be established in order to recover loss or damages. Moreover, tribunals cannot order States "to take or not to take actions, including the amendment, repeal, adoption, or implementation of a law or regulation." *See also* footnote 27. Finally, at the top tier of Chapter 14's protections is Annex 14-E "Mexico-United States Investment Disputes Related to Covered Government Contracts" in which investors with disputes related to government contracts or activities in the oil and gas, power generation, telecommunications, transportation and road, railway, bridge or canal

concessions are granted additional rights (*See* Annex 14-E, paragraphs 2 and 6). These investors receive the full panoply of the modern substantive protections found in the Chapter. Moreover, these types of claims are not subject to the exhaustion of local remedies requirements and restrictions found in Annex 14-D (*See* Annex 14-E, footnote 32). In fact, claims must be brought within the more traditional three years from discovery of a breach (*See* Annex 14-E, paragraph 4).

The Politics behind the Agreement

Chapter 14 of the USMCA is a complicated investment protection vehicle and we can only speculate as to why it was structured in this manner. The contemporaneous political context may offer the most plausible answer. The Trump Administration came into office promising to get rid of NAFTA and expressing particular hostility to investment protection, which the U.S. Trade Representative views as an insurance policy for U.S. investors moving manufacturing operations south to Mexico. For some time, the official U.S. position was that there would be no investment arbitration in a new agreement. The hostility of Andrés Manuel López Obrador, who took office as president of Mexico at the end of 2018, to the privatization of the energy sector by his predecessor may have led to a shift in U.S. policy. If the change in the Mexican government led the Trump Administration to reconsider the scope of investment protection in the USMCA, the shift was prescient. López Obrador's hostility to his predecessor's reforms was recently manifested when recent regulations were introduced that could adversely affect U.S. investments in the power generation sector.

The USMCA Investment Chapter also reflects certain policy and practical considerations. First, with respect to the elimination (in three years) of the right of U.S. investors to sue Canada, it is worth remembering that pre-NAFTA there was the Canada-United States FTA (CFTA). CFTA had limited substantive protections, there was no MST, and it did not include investment arbitration. Claims under NAFTA by Canadian investors related to sensitive issues such as environmental regulation, "Buy America" provisions, trade policy, and judicial decisions, have been the lightning rod for opposition to investment arbitration in the United States. It is also worth remembering that a primary justification for investor-state arbitration is the perceived inadequacy or prejudice of foreign courts. Neither U.S. nor Canadian investors can seriously argue that the other's courts are not capable

of fairly resolving their disputes with the U.S. and Canadian governments, particularly given similarities in the countries' common law-based justice systems. Similarly, the Australia-United States FTA does not include an automatic right to investor-state arbitration, a recent precedence with a similar type of trading partner. In FTAs, the final provisions are the result of a balancing by states parties between market access (trade and investment), other bargained-for benefits, and exposure to trade regulation. Canada got an arguably stronger trade remedies dispute resolution provision than exists in NAFTA, and perhaps, given remedies available for its investors in U.S. courts, that was worth more to it than investment arbitration.

From a policy perspective, the Mexico-U.S. investment provisions protect U.S. investors in a lop-sided manner – most noticeably favoring investors in the oil and gas and power generation sectors where there has been significant investment in the last five years. Obviously, this disparity concerns investors and practitioners, but it has to be viewed within the context of the original position of the Trump Administration – no investment arbitration at all. It also provides some insight into the Administration's thinking on investment protection that could be useful for those who want to persuade the Administration to reconsider CP-TPP.

Future Complexities

There are practical or interpretative concerns with the two annexes governing investor access to arbitration. First, in maintaining NAFTA 1994 for the next three years (and it can be presumed there will be a flood of claims prior to termination), is the Administration creating an unintended bifurcation in investor rights? For example, it is not clear that NAFTA 1994 includes the incorporation of the 2001 Interpretation which has largely been followed by NAFTA tribunals. Or is the Administration relying on future tribunals to make that determination? So much of what exists in the main section of Chapter 14 reflects years-long efforts to address deficiencies in NAFTA 1994 or what the Parties have viewed as stray awards.

From a policy and strategic litigation standpoint, this bifurcation may create certain challenges. Mexico, or the United States, could find itself having to simultaneously defend claims that require different interpretations of provisions that are supposed to be the same in cases brought under both NAFTA 1994 and

the USMCA. Since the likely objective was to protect extant Canada-related claims, as well as some U.S.-Mexico claims, why not "grandfather" such claims but to Chapter 14? On the other hand, arguably there is fertile ground in the various "tiering" of rights in the USMCA for practitioners to protect effectively their clients' interests. In addition, as with the NAFTA, it remains to be seen what tribunals will do with any textual uncertainty. So, while there may be valid concerns regarding policy consistency, it remains to be seen whether the change in policy as reflected in the USMCA text is really a reversal of fortune for extant investors.

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