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200 Billion Reasons for Keeping NAFTA

Carlos Alvarado (Hogan Lovells International LLP) · Wednesday, April 26th, 2017

NAFTA on the tightrope

One of President Donald Trump's most frequent campaign promises was to "*eliminate*" the North American Free Trade Agreement ("NAFTA"), which he described as "*the worst trade deal maybe ever signed anywhere, but certainly ever signed in this country.*" He then softened his tone and stated that he would renegotiate the treaty, but tweeted "*I will renegotiate NAFTA. If I can't make a great deal, we're going to tear it up.*" So far, however, President Trump's "*great deal*" seems to be a long way from terms that Mexico would consider to be acceptable. Mexico has already stated that it is not in a rush to renegotiate NAFTA and made clear that it will not accept any deal just to preserve the treaty.

Whether NAFTA is "*eliminated*" or subjected to renegotiation, its survival is at stake. The impact that NAFTA's termination would have for trade for the U.S., Canada and Mexico, regionally and even globally, has been extensively discussed. However, it is important to also consider NAFTA's Chapter Eleven ("Chapter Eleven") and the potential effect on investment protection.

U.S. FDI in Mexico

Chapter Eleven regulates the treatment of investments by offering substantive protections (Section A) and provides a mechanism for settling disputes that arise from Section A (Section B), which gives access to investors to investment arbitration directly against a host State. Investors from the three members of NAFTA benefit from Chapter Eleven; however, the largest category of investments made in reliance upon Chapter Eleven is made up by U.S. investors in Mexico.

The U.S. is the biggest investor in Latin America and the Caribbean, with total Foreign Direct Investment ("FDI") of US $404 billion in 2014 (compared to only US $60 billion of investment from Canada), and Mexico is one of the biggest recipients of such investment. From 1999 to early 2016, Mexico received a total of US $436 billion of FDI and almost US $200 billion (45%) of such FDI inflows came from the U.S.

U.S. FDI into Mexico still seems to be increasing. In 2015 US $15.7 billion of FDI in Mexico came from the US, 103% more than in 2014. Among other megadeals, the U.S.'s AT&T and Owens-Illinois Inc. recently invested around US $4.5 billion in Mexico through the acquisitions of Grupo Iusacell and Vitro, respectively. FDI in Mexico is also expected to increase as result of its recent Energy Reform, which opened the energy sector to private investment. All of those investments are, in principle, protected by NAFTA.

In addition to substantive protections, investors under NAFTA also have a right to resort to investment treaty arbitration. NAFTA is the second most invoked treaty in investment arbitration disputes, after the Energy Charter Treaty ("ECT"). In 2016, 4% of the new cases registered or administered by ICSID were brought under NAFTA. This is a high number considering that NAFTA only has three signatories, in contrast with the ECT, which has more than 50 signatories. The U.S. also has the highest proportion of claimants, with 138 claims as of the end 2015 (known cases).

Survival clauses

Survival clauses are provisions that, upon the termination of an investment treaty, extend the effects of the treaties or certain parts of it, typically for periods of 5 to 25 years. For instance, the UK Model BIT 2008 states that "*in respect of investments made whilst the Agreement is in force its provisions shall continue in effect with respect to such investments for a period of twenty years after the date of termination*"; or the US Model BIT 2012 provides "*For ten years from the date of termination, all other Articles shall continue to apply to covered investments established or acquired prior to the date of termination…*". Investments made under a treaty (based in these models) during such treaties' validity will be protected for 20 and 10 years, respectively, after the treaties' termination.

An OECD study of more than 2000 investment treaties found that 97% of these contain survival clauses (with an average survival period of 12.5 years). This is not surprising: it grants investors the certainty that their investments made in a foreign country will be protected for at least that minimum period, regardless of the political agendas of the host and home States' regimes.

What about NAFTA?

If a renegotiation of NAFTA was to fail, President Trump would need to make good on his promise of "*eliminating*" NAFTA. Article 2205 of NAFTA allows to any of its parties to withdraw from it, and the treaty would remain in force for the remaining signatory parties. A member State only needs to provide written notice of withdrawal to the other two member States and six months later, such member State would no longer be part of NAFTA.

Unluckily for NAFTA investors, NAFTA is one of the 3% of investment treaties that do not contain a survival clause. Chapter Eleven's effects would not be extended after the termination or withdrawal of the treaty. Therefore, six months after serving notice of withdrawal on Canada and Mexico, the U.S. would no longer be part of NAFTA and U.S. FDI in Mexico would no longer be protected under Chapter Eleven.

As soon as any U.S. withdrawal from NAFTA became effective, all the U.S. existing investments in Mexico (around US $200 billion), together with all new FDI inflows coming from the U.S. to Mexico, would no longer enjoy the substantive protections granted by NAFTA (e.g. national treatment, most favoured nation treatment, minimum standard of treatment, fair and equitable treatment, full protection and security, non-discriminatory treatment, no expropriation without compensation). Moreover, U.S. investors would no longer have access to investment treaty arbitration and the international approach therein used against Mexico. In the event of any violation by the host State of applicable Mexican legislation, the affected investor would be obliged to litigate and seek relief from the Mexican courts.

If President Trump's administration wants to keep U.S. investors in Mexico happy, he will definitely need to think carefully about NAFTA. Chapter Eleven will be certainly a relevant part of the negotiations between NAFTA's three signatories, but if President Trump is really ready for leaving NAFTA, he should have a plan B for protecting the more than US $200 billion invested by U.S. investors in Mexico. In the meantime, do not be surprised if notices of intent of arbitration under NAFTA's Article 1119 from U.S. investors to Mexico increase significantly, in order to gain the benefit of NAFTA's substantive protections and anticipate establishment of jurisdiction of an investment arbitration panel.

**The views and opinions expressed on this blog are solely those of the author and do not necessarily represent Hogan Lovells' views or opinions.*

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