Kluwer Arbitration Blog

Three Years and Three Decades On: Reflecting on the Final Sunset of NAFTA and USMCA's Sunrise

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On June 30, 2020, an era of international investment law and dispute resolution came to an end as the North American Free Trade Agreement (NAFTA) concluded its 27-year tenure with the entry into force of United States – Mexico – Canada Agreement (USMCA). Three years later, a further milestone is now marked: today, Canada, which is not a party to the investor-State dispute settlement (ISDS) mechanism provided in Chapter 14 of USMCA, has seen its consent for legacy claims under NAFTA expire. This post marks this important milestone and reflects on three decades of NAFTA to consider what a future with USMCA may hold.

NAFTA: A Symbol of a "Balanced" Era of International Investment Law?

When NAFTA entered into force in 1994, it was lauded for facilitating increased trade and unprecedented economic benefits by creating the then-largest free trade zone in the world. To support investor confidence, NAFTA included Chapter 11, which provided an ISDS mechanism for arbitration under UNCITRAL or ICSID Additional Facility Rules. As we have written previously several times, commentators focused on the "balanced" treatment enabled by this ISDS mechanism. Each State party to NAFTA agreed that their respective investors may pursue investment claims against either of the other parties. The fact that NAFTA facilitated investment claims between two States with developed economies (the US and Canada) was a notable feature in the landscape of investment treaties at the time, most of which facilitated a capital-exporting and capital-importing dichotomy (sometimes also characterized as a North-South relationship).

Numerous ISDS claims prompted deeper examination – by both the NAFTA parties and beyond – of the benefits and drawbacks of the Chapter 11 ISDS mechanism. Over the decades, dozens of investor claims were brought against each NAFTA party. This was unexpected for the US and Canadian governments. Both had expected NAFTA to protect their own investors, rather than trigger claims that they would have to defend. As explained by Professor Ian Laird in 2001:

> "The main response of government officials who negotiated Chapter 11, or act on the government side of disputes, is that 'we did not intend NAFTA to mean that.' What they are really saying is that Chapter 11 was intended to protect Canadian and US

> investments from arbitrary or discriminatory conduct of the Mexican government, and that Canada and the US should never attract claims. They never thought that their own governments might violate international treatment obligations." (at p. 230)

Notable examples of such claims include *Loewen Group, Inc. et al. v. United States* (ICSID Case No. ARB(AF)/98/3), *Methanex Corporation v. United States* (UNCITRAL) and *Eli Lilly and Company v. Canada* (ICSID Case No. UNCT/14/2).

Meanwhile, NAFTA's terms and related ISDS practice provided a microcosm for the broader development of international investment law and practice. As Barton Legum and Sean Stephenson have observed on this Blog, "*computational analysis of the* [Trans-Pacific Partnership]*'s investment chapter has noted that 81% of the text has been taken from previous US investment treaties, with 58% of its text similar or identical to the NAFTA itself*" (citing Wolfgang Alschner and Dmitriy Skougarevskiy). NAFTA arbitrations, given their sheer number, have provided the arbitration community with opportunities to study and understand effective practice under the UNCITRAL Rules and ICSID Additional Facility Rules. Scrutiny of NAFTA arbitrations has also influenced the latest ISDS reform efforts and procedural rule amendments, including for example the development of transparency measures and evidentiary procedures. Further, NAFTA practice has influenced ISDS scholarship and substantive developments, including for example, by providing a forum to better understand the legal consequences of joint interpretive notes. At the Blog, we have published more than 50 posts discussing NAFTA practice.

USMCA: Balance No More

From May 2017 to September 2018, in the shadow of the protectionist foreign policy attitude of US President Trump's administration, the US, Canada and Mexico embarked on a renegotiation and modernization process to develop what was then-dubbed "NAFTA 2.0." In October 2018, negotiations concluded and a signing ceremony for the new agreement – USMCA – was held at the G-20 Summit in Buenos Aires. Mexico was the first party to ratify USMCA, in January 2019, and Canada became the final party to ratify in April 2020.

A comparison between the ISDS mechanisms in NAFTA and USMCA is particularly revealing of the shifting attitudes of these States towards the role for investor-State claims within their trade and investment relationships. Chapter 14 of USMCA provides an ISDS mechanism that departs in many ways from Chapter 11 of NAFTA.

Glaringly, Canada is not a party to the Chapter 14 ISDS mechanism. This means that while Canada remains a party to USMCA, ISDS claims cannot be asserted by Canadian investors, nor asserted against Canada.

The investment arbitration mechanism survives for the benefit of US and Mexican investors, albeit with changes to the types of claims that investors may pursue and the procedural prerequisites for doing so. For the US and Mexico, Chapter 14 includes, for instance, a local litigation requirement. Once that requirement is met, claims may be asserted for: (1) direct (but not indirect or "creeping") expropriation (Annex 14-B (Expropriation), Article 2), (2) violations of national treatment (Article 14.4.1), or (3) violations of USMCA's Most Favored Nation (MFN) provision (Article 14.5.1). There is a carve-out for MFN claims concerning "*the establishment or acquisition of an*

investment" (Annex 14-D, note 22). Chapter 14 also includes a novel asymmetrical fork-in-the-road provision that applies to US investors only.

In many ways, ISDS insofar as it is provided for in USMCA reflects ideas currently circulating globally on possible options for achieving ISDS reform. Specific substantive rights and procedural approaches are also provided for claims concerning government contracts in several highly regulated sectors ("privileged") including energy, telecommunications, transportation, and infrastructure (Annex 14-E, Article 6).

Vestiges: Canada's Consent for Legacy Claims and Avenues under USMCA Chapter 31

Canada's consent for legacy claims under NAFTA was set to expire three years after NAFTA's termination (often referred to as NAFTA's "sunset" period). As such, the deadline for filing legacy claims is today, July 1, 2023. Practically speaking, the deadline expired several months ago. A notice of intention to submit a claim on a "legacy investment" was due at least 90 days before initiation of arbitration (i.e., April 2, 2023). A "legacy investment" is "*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*" (USMCA, Annex 14-C, Article 6(a)).

Legal advisers and law firms have spent the past three years encouraging prospective claimants to get their claims in to avoid a "Black Friday"-style rush. According to the website of Global Affairs Canada, Canada is currently engaged in a total of six ongoing investment arbitrations all of which arise under NAFTA and two of which appear to have been formally initiated since the entry into force of USMCA: *Koch Industries, Inc. and Koch Supply & Trading, LP v. Canada* (ICSID Case No. ARB/20/52; Request for Arbitration filed on December 7, 2020) and *Westmoreland Coal Company v. Canada*, ICSID Case No. UNCT/23/2, Request for Arbitration filed on October 14, 2022). Public information reveals that there are at least two further NAFTA investment claims pending against Canada that are not listed on the Global Affairs Canada website. *Einarsson and others v. Canada* (ICSID Case No. UNCT/20/6) was registered in 2019 while ratification of USMCA was pending, with the tribunal constituted in August 2020 shortly after USMCA's entry into force. *Ruby River Capital LLC v. Canada* (ICSID Case No. ARB/23/5) was registered in February 2023 and the tribunal was reportedly constituted about a week ago. There may be additional claims already in the queue where Canada has been provided a notice of intention to submit a claim and the formal claim remains forthcoming.

Legacy claims are also being pursued by Canadian investors against the other NAFTA parties, with the latest claim filed just a few days ago by Canadian investor Enerflex against Mexico.

As of today, absent any other agreement to arbitrate, US and Mexican investors in Canada and Canadian investors in the US and Mexico no longer have access to an ISDS mechanism under USMCA. Options for redress are therefore narrowing. This may well prompt investors to consider restructuring their investments to access other ISDS mechanisms, including for example, the ISDS mechanism under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), to which both Mexico and Canada are parties.

Under USMCA itself, one avenue may be provided by Chapter 31's State-State dispute resolution mechanism. The scope of dispute settlement under USMCA Chapter 31 is narrower than NAFTA's

State-State dispute settlement framework; however, as we have written previously, Chapter 31 reflects some thoughtful evolutions. A State-State proceeding of course must be initiated by a NAFTA party itself and not by an investor from that country. Once a State identifies a dispute, consultation with technical experts and the Free Trade Commission is required. Upon failure of such consultations, a binational panel may be convened to assist the Members to resolve their dispute. Practically speaking, Chapter 31 is where most disputes about the interpretation or application of USMCA's obligations are likely to fall.

To date, the US has convened two consultations under Chapter 31. In July 2022, the US requested consultations with Mexico concerning certain measures by Mexico that allegedly undermine US companies and US-produced energy in favor of Mexico's state-owned electrical utility, CFE, and state-owned oil and gas company, PEMEX. More recently, in January 2023, the US established a dispute settlement panel regarding Canada's dairy tariff-rate quota allocation measures.

Sunset or New Dawn?

In a previous post, Devin Bray and Jason Czerwiec speculated the most likely casualties of Canada's abstention from USMCA's ISDS mechanism may be small- and medium-sized enterprises, which have less legal sophistication and may lack the capacity to secure valuable government contracts in "privileged" sectors. Such investors may also lack the ability to restructure their investments as needed to secure greater investment protection through other investment treaty avenues.

At a broader level, ISDS remains – for now at least – alive and well for Mexico, the US and Canada. Mexico and Canada are both, for instance, party to the CPTPP. Separately, Canada has reaffirmed its commitment to ISDS in its 2021 Foreign Investment Promotion and Protection Agreement Model (2021 Model). The prior iteration of the FIPA Model was broadly understood to have been influenced by Canada's experience under the NAFTA regime. Similarly, the 2021 Model benefits from Canada's continued trade and investment experience, recent trends in investment treaty law, and the latest debates on the future of ISDS. The precise features of the 2021 Model are discussed in-depth in a prior post that one of us coauthored with Dina Prokic.

Only time will tell how the transition from NAFTA to USMCA will impact the broader trade and investment environment and the benefits derived in particular by each State party. After the November 2018 signing ceremony, President Trump tweeted that USMCA represents "*one of the most important, and largest, Trade Deals in U.S. and World History*." This is likely true. USMCA is expected to account for more than $1.2 trillion in trade in one of the world's largest free trade zones. Importantly, USMCA must be reviewed and renewed by its parties before the sixth year following its entry into force (i.e., 2026), thus the period to begin that review process is quickly approaching. It will be interesting to see then whether it is meeting the standards necessary to remain in effect in its current form.

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