Future of investor-state dispute settlement mechanisms under the United States – Mexico – Canada Agreement

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Dentons discusses the impacts of the new United States – Mexico – Canada Agreement (USMCA) on different industries in a series of short articles. This article focuses on the investor-state arbitration provisions in Chapter 14 of the USMCA, which represent a significant departure from the investment protections in Chapter 11 of the North American Free Trade Agreement (NAFTA). First, and perhaps most importantly, notwithstanding there are three member states, once in force, the USMCA will provide only a bilateral system of investor-state arbitration between the US and Mexico, excluding Canada from this dispute resolution mechanism. A second critical difference is in the nature of the substantive protections that would be available under Chapter 14 going forward. Below are some perspectives on these potential changes.

Canadian perspective

Article 14.2 and Annex 14-D of the USMCA, limit the scope of investor-state arbitration. Under these provisions, only Mexico and the US have given their consent to investor-state arbitration with respect to claims from investors of the other state. If the USMCA is entered into force, Canadian investors in the US will no longer have recourse to such an arbitration system. Instead, they will need to rely on domestic courts to pursue contractual or other remedies, or may need to try to escalate any investment disputes to the state-to-state level, making use of the dispute resolution process within Chapter 31 of the USMCA.

Similarly, Canadian investors in Mexico won't have recourse to investor-state arbitration under the USMCA, but might be able to look beyond the USMCA and take advantage of the investor-state dispute settlement (ISDS) provisions in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). On March 8, 2018, 11 countries, including Mexico and Canada, signed the CPTPP. Mexico became the first to ratify the agreement on April 24, 2018, and the Canadian legislation required to ratify the CPTPP (Bill C-79) received royal assent on October 25, 2018, with Canada filing its ratification notice accordingly. Following Australia's ratification of the agreement (after Singapore, New Zealand and Japan) on October 31, 2018, the CPTPP is set to enter into force on December 30, 2018.

Chapter 9 of the CPTPP provides for an investor-state arbitration regime. However, a number of the provisions regarding the type of dispute that can be resolved through this chapter have been suspended by agreement of the parties, and various Side Letters between some parties either remove the applicability of Chapter 9 altogether, or implement a separate, tiered and, in some cases, opt-in arbitration procedure. Canada is not a party to such Side Letters, but through a Joint Declaration on Investor State Dispute Settlement has, along with New Zealand and Chile, indicated its favour of the Chapter 9 arbitration procedure, with the caveat that Canada intends "to consider the evolving international practice and the evolution of ISDS including through the work carried out by multilateral international fora." While somewhat vague, this indicates the potential for Canada to review the investor-state arbitration provisions in Chapter 9 going forward.

There are some specific suspended provisions when the CPTPP comes into force that limit potential claims under Chapter 9 along with some nuanced restrictions in the available protections. Generally speaking, however, the claims that could be brought include those for typical alleged violations of national treatment, most-favoured-nation treatment and the minimum standard of treatment, amongst others. As would be expected, the language and phrasing of these protections are not identical to what is in Chapter 11 of NAFTA.

If the USMCA takes effect, it is possible another agreement would be concluded between Canada and the US to provide for investor-state arbitration, whether that is the US joining the CPTPP or otherwise. Until such a time, if the USMCA takes the place of NAFTA, Canadian investors in the US may want to consider restructuring their investments if they want the ability for recourse to investor-state arbitration.

Mexican perspective

Foreign investment plays a major role in the Mexican economy and its development, representing around 20 percent of Mexico's economic activity depending on foreign markets, and foreign investment is responsible for more than 40 percent of Mexico's Gross Domestic Product. In particular, Canadian and US investments in Mexico represent more than 50 percent of foreign direct investment in Mexico. Perhaps because of this, despite not being a signatory party of the ICSID Convention until recently, Mexico (along with Canada) has been one of the most active respondent States in ISDS procedures thus far, many of them deriving from NAFTA protections.

As discussed above, Chapter 14 of the USMCA sees the exit of Canada from the ISDS system included in the USMCA, and reduces the protections available to US investors in Mexico, as the potential grounds for an investor-state claim are reduced. For Canadian investors in Mexico, the protections granted under the CPTPP contain certain limitations on the types of disputes that can be resolved through the ISDS mechanism thereunder. For example, there are some situations for which Mexico has carved-out its consent to investment arbitration under the CPTPP with respect to government contracts related to development of infrastructure for the country. This could impact oil exploration and production contracts, as well as Public-Private Partnerships and contracts of public works, and concessions over airports and maritime ports. Also, alleged violations of foreign investment protections by Mexican courts cannot be claimed in ISDS procedures.

Under Chapter 14 of the USMCA, the limitations of ISDS between the US and Mexico could potentially restrict the activities of Mexican investors in the US, and US investors in Mexico, or change how these entities approach their investments. For example, a potential concern is the limitation on the ability to submit claims for indirect expropriation, which are expressly carved out from the protections that can be subject to an ISDS arbitration procedure. Chapter 14 of the USMCA also alters the scope of certain protections - *e.g.*, national treatment or minimum standard of treatment – attempting to establish different standards for proving violations to these protections when compared to the decisions rendered under NAFTA. Notwithstanding the foregoing, there is yet another scheme of protections for rights granted in government contracts in a so-called "covered sector", which includes the oil and gas industry.

The changing developments in this area, and its connections to and reliance upon political fluctuations, make this an important area for regulated sectors of the economy and investors to follow, in particular with the upcoming inauguration of President-elect Andrés Manuel López Obrador on December 1, 2018, and change in government.

US perspective

Under Chapter 14 of the USMCA, US investors in Mexico and Mexican investors in the US will have fewer potential bases for a claim and will have to undertake potentially onerous domestic litigation before initiating arbitration. The exception to this is where they are relying on a government contract in a covered sector—oil and gas, power

generation to the public, telecommunications, transportation, and ownership or management of infrastructure.

This is because the scope of investor-state dispute settlement for US investors in Mexico has been significantly weakened. These changes appear to reflect the Trump Administration's protectionist views as to whether ISDS mechanisms truly benefit US domestic industries. Because strong ISDS protections for US investors abroad tend to facilitate US investment in foreign countries, the Trump Administration has sought to curtail such protections in the USMCA. However, it should be noted that the reciprocally weakened ISDS protections for Canadian and Mexican investors in the US may have the less desirable effect of decreasing investments in the US.

While weakened ISDS protections may be seen as a win for the Trump Administration's "America First" policy mindset, much remains to be seen before (and if) the USMCA becomes fully effective. Powerful industry groups, including US investors in Canada and Mexico with no or limited recourse under the USMCA's new ISDS mechanisms, may lobby against the new pact. Moreover, the Trump Administration may face opposition from within President Trump's own political party. In March 2018, Senator Orrin Hatch (R-UT), Chairman of the Senate Finance and Representative Kevin Brady (R-TX), Chairman of the House Ways and Means Committee, led 99 of their Republican colleagues in a letter to US Trade Representative Robert Lighthizer to warn him that revisions to NAFTA may not make it through Congress if ISDS provisions are not "at least as strong as those contained in the existing NAFTA."

In this uncertain atmosphere, investors with potential claims may consider initiating a claim under NAFTA while it is still in force. Going forward, US investors considering current or new investments in Canada or Mexico should consider whether foreign investments could be better protected by other means, such as contractual provisions mandating arbitration as a form of dispute resolution or other bilateral investment treaties.

Takeaways

It may be years before we fully know the fate of the USMCA and NAFTA, as the US, Mexico and Canada must each ratify a finalized USMCA in their respective domestic legal systems before it can enter into force. If the USMCA enters into force, and NAFTA is not terminated before such entry into force, the current protections under NAFTA Chapter 11 would carry over under certain legacy provisions. Annex 14-C of the USMCA sets out the transitional provision for any "legacy investment" claims, and gives the former NAFTA parties three years to bring a claim to arbitration for investments established or acquired while NAFTA was in force. The process and substantive protections under NAFTA would appear to apply to such claims. Investors will want to keep track of how NAFTA and the USMCA proceed, as aside from other relevant limitation periods, the status of these agreements could impact whether or when to bring a claim. The status of these agreements could also influence how investors might want to structure, or potentially restructure, their investments going forward.

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