NAFTA 2.0: Investment Protection and Dispute Settlement Under Chapter 14 of the United States-Mexico-Canada Agreement

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After more than a year of sometimes contentious negotiations, the United States, Mexico, and Canada reached an agreement on September 30 to revise the North American Free Trade Agreement (NAFTA)—renaming it the United States-Mexico-Canada Agreement (USMCA). Although the substantive protections for foreign investment in Chapter 14 of the USMCA largely track those in Chapter 11 of the NAFTA, the scope of investor-State dispute settlement is drastically reduced. These changes appear to reflect the Trump Administration's broader skepticism of international dispute resolution mechanisms. Moreover, in a significant departure from the NAFTA, Canada has not signed on to the investment arbitration mechanism. This means that U.S. and Mexican investors cannot bring claims against Canada under the USMCA, nor can Canadian investors bring such claims against Mexico or the United States.

Changes to Investment Protections

There are three changes of potential importance to the substantive investment protections in Chapter 14 of the USMCA, as compared to Chapter 11 of the NAFTA: (i) the definition of investment in Article 14.1; (ii) the definition of claimant under Article 1 of Annex 14-D; and (iii) the provision on the minimum standard of treatment for investments in Article 14.6.

Under Article 1139 of the NAFTA, "investment" is defined by a closed list of examples that include "an enterprise," "real estate or other property, tangible or intangible," and certain kinds of contracts. In contrast, Article 14.1 of the USMCA—like other recent U.S. free trade agreements—defines investment in a manner more typical of investment treaties, as "every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk." This more general definition is then followed by an open list of examples, with an express exclusion only for "an order or judgment entered in a judicial or administrative action" and "claims to money that arise solely from commercial contracts for the sale of goods or services" and related extensions of credit. It remains to be seen whether this potentially more expansive definition of investment will be interpreted in a materially different way than Article 1139 of

the NAFTA.

Under Article 1 of Annex 14-D of the USMCA, “claimant” is defined as “an investor of an Annex Party [i.e., the United States or Mexico], excluding an investor that is owned or controlled by a person of a non-Annex Party that the other Annex Party considers to be a non-market economy, that is a party to a qualifying investment dispute.” This restriction on U.S. or Mexican claimants owned or controlled by a national or enterprise of a non-market economy is new compared to the NAFTA and appears to be directed at Chinese-owned or -controlled investments in the United States and Mexico. While both the NAFTA (in Article 1113) and the USMCA (in Article 14.14) already contain denial of benefits clauses, those clauses only allow a respondent State to deny the benefits of the investment chapter —including access to investor-State arbitration—to an enterprise of another Party that is owned or controlled by third-State nationals and that has no substantial business activities in the territory of the Party in which it is incorporated. The new exclusion for U.S. or Mexican claimants owned or controlled by a national or enterprise of a non-market economy is broader because it excludes a would-be claimant from arbitration even where the U.S. or Mexican company engages in substantial business activities in its State of incorporation.

Finally, Article 14.6 of the USMCA requires the Contracting Parties to “accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.” This language is almost identical to that found in Article 1105(1) of the NAFTA. The USMCA, however, also incorporates the clarification in the NAFTA Free Trade Commission’s July 31, 2001, statement to the effect that the treatment required is limited to the customary international law minimum standard of treatment. Article 14.6 of the USMCA goes further than the FTC’s statement by providing that “the mere fact that a Party takes or fails to take an action that may be inconsistent with an investor’s expectations does not constitute a breach of this Article, even if there is loss or damage to the covered investment as a result.” This new provision, at Article 14.6.4, appears directed at recent NAFTA awards relying on the respondent State’s frustration of an investor’s legitimate expectations about the stability of the regulatory environment in finding a violation of the minimum standard of treatment in Article 1105(1). The language in Article 14.6.4 codifies the litigation position of the NAFTA Parties in responding to these claims and may further constrain tribunals’ interpretation of the scope of the minimum standard of treatment.

Changes in Dispute Settlement

Turning to dispute settlement, the most significant changes to Chapter 14 of the USMCA in comparison to the NAFTA relate to the investment arbitration mechanism as laid out in Annexes 14-C, -D, and -E. Perhaps the biggest change, noted above, is that Canada has not signed on to Annexes 14-D and -E. As a result, other than for Legacy Claims under Annex 14-C (discussed below), U.S. and Mexican investors cannot bring arbitration claims against Canada under the USMCA, nor can Canadian investors bring such claims against the United States or Mexico. (Canadian investors in Mexico and Mexican investors in Canada will, however, have access to investment arbitration under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership once it enters into force.) There are also numerous changes to the investment arbitration regime for claims against Mexico (by U.S. investors) or the United States (by Mexican

investors).

The Annexes to Chapter 14 of the USMCA create three categories of claims:

1. **Legacy Claims**. Investment arbitrations that are ongoing under the NAFTA may continue (Annex 14-C, paragraph 5). In addition, investors that have made investments covered by the NAFTA before it is terminated have three years from the date of termination of the NAFTA in which they can bring a claim under the provisions of the NAFTA (Annex 14-C, paragraphs 1, 3, and 4). This is important because investment arbitration under the USMCA is significantly more limited than under the NAFTA, as discussed below. Those U.S. or Mexican investors that are eligible to submit claims under Annex 14-E, however, must use that mechanism even if they would otherwise qualify for arbitration under the NAFTA (Annex 14-C, footnote 21).
2. **Mexico-United States Investment Disputes**. The majority of claims under the USMCA will likely arise under Annex 14-D. The arbitration mechanism in Annex 14-D is similar to that in Section B of NAFTA Chapter 11, but there are some key differences. First, the substantive basis for investment claims under Annex 14-D of the USMCA is limited. Most importantly, an investor cannot bring a claim for breach of the minimum standard of treatment in Article 14.6 or for indirect expropriation under Article 14.8 (Annex 14-D, Article 3). Given that these have been the two most-often used bases for claims under the NAFTA, their exclusion from the arbitration mechanism under Annex 14-D makes the protections under the USMCA of significantly less value to investors than the protections that are currently available under the NAFTA. Claimants under Annex 14-D can only bring claims for certain kinds of national treatment and most-favored-nation treatment (MFN) violations and for direct expropriations (Annex 14-D, Article 3). National treatment and MFN claims related to the establishment or acquisition of an investment are also excluded; a claimant is therefore limited to claims alleging discrimination with respect to the "expansion, management, conduct, operation, and sale or other disposition of investments" (Articles 14.4 and 14.5). Moreover, a claimant may not use the MFN clause to seek to incorporate more favorable substantive protections from other investment treaties to which the United States or Mexico is a party (Annex 14-D, footnote 22).[1]

   Second, in contrast to the NAFTA (and most other investment treaties), the USMCA requires that a would-be claimant first litigate the challenged measure "before a competent court or administrative tribunal of the respondent" (Annex 14-D, Article 5). The claimant must litigate until it receives a "final decision from a court of last resort" or 30 months have passed from the date the local court proceedings were initiated. This time counts against the four-year statute of limitations for claims under Annex 14-D. Moreover, if U.S. investors in Mexico allege a breach of the USMCA itself (as opposed to a breach of Mexican law) in the local court proceedings, this will bar any subsequent investment arbitration (Annex 14-D, Appendix 3). There is an exception to this local litigation requirement "to the extent recourse to domestic remedies was obviously futile or manifestly ineffective" (Annex 14-D, footnote 24).

Third, there are some procedural innovations in the USMCA compared to the NAFTA. For example, if the disputing parties fail to agree on a place of arbitration, the tribunal may choose a place of arbitration in any State party to the New York Convention (Annex 14-D, Article 7.1). The NAFTA, in contrast, limits the tribunal to a place of arbitration within the NAFTA States (Article 1130). This change may be due to the fact that the limitation of investment arbitration to two States, rather than three, means that there is no "neutral" third State party to the treaty in which an arbitration can be seated. The USMCA also establishes a mechanism for the expedited consideration of jurisdictional objections and objections that a claim is manifestly without legal merit (Annex 14-D, Articles 7.4 and 7.5), along the lines of the mechanism in Article 10.20 of the CAFTA-DR. Unusually, the USMCA provides the disputing parties a right to review and comment on a draft of the award before it is issued (Annex 14-D, Article 7.12).

In addition to transparency provisions ensuring the publication of arbitration-related documents and access to hearings (Annex 14-D, Article 8) and permitting amicus participation (Annex 14-D, Article 7.3), the USMCA also imposes certain ethical obligations on arbitrators (Annex 14-D, Article 6.5). Specifically, arbitrators must comply with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration and refrain from taking instructions from any organization or government regarding the dispute. The USMCA also prevents "double-hatting" by requiring arbitrators to "refrain, for the duration of the proceedings, from acting as counsel or as party-appointed expert or witness in any pending arbitration under the annexes to this Chapter." These obligations can be seen as a response to criticisms that arbitrators in investment disputes currently lack sufficient independence.

3. **Mexico-United States Investment Disputes Related to Covered Government Contracts**. In contrast to the limited set of claims available under Annex 14-D, Annex 14-E allows investment arbitration for alleged breaches of any of the substantive protections in Chapter 14 (including indirect expropriation and violation of the minimum standard of treatment) for disputes related to covered government contracts. Annex 14-E does not include the pre-arbitration local litigation requirement that applies to U.S. and Mexican claimants under Annex 14-D.

   Covered government contracts are limited to written agreements between an investor or investment and a "national authority" of the respondent State related to certain sectors, which the investor relied on in making its investment. The covered sectors are oil and gas, power generation, telecommunications, transportation, and ownership or management of infrastructure. This provision appears intended to provide additional protections to U.S. investors, especially in the oil and gas sector, that have entered into contracts with Mexican national authorities.

   Certain caveats apply even to arbitration under Annex 14-E. Claimants must wait at least six months from the events giving rise to the claim before initiating arbitration (Annex 14-E,

paragraph 4). There is also a three-year statute of limitations for claims (Annex 14-E, paragraph 4). The respondent State must be a party to at least one other "international trade or investment agreement that permits investors to initiate dispute settlement procedures to resolve an investment dispute with a government" (Annex 14-E, paragraph 2(a)(i)(B)). And the United States and Mexico expressly retain the right to "modify or eliminate this Annex" (Annex 14-E, paragraph 5).

Conclusion

The investment arbitration provisions in the USMCA represent a significant departure from the NAFTA. U.S. and Mexican investors in Canada cannot bring claims against Canada under the USMCA, nor can Canadian investors bring such claims against the United States or Mexico. U.S. and Mexican claimants will have fewer potential bases for a claim (except where they are relying on a government contract in a covered sector) and will have to undertake potentially onerous domestic litigation before initiating arbitration.

The USMCA still has to clear major hurdles, as the United States, Canada, and Mexico must each ratify the agreement in their domestic legal systems before it can enter into force. In the United States, that will require Congress to pass implementing legislation. The timing of a Congressional vote is uncertain as of this writing. Nevertheless, in light of these possible changes, investors with potential claims may choose to consider initiating a claim under the NAFTA while it is still in force or during the three-year sunset period under the USMCA, rather than waiting until a later time when they may be limited to bringing claims under Annex 14-D of the USMCA. More generally, going forward, U.S. investors may have to consider other potential means of protecting their investments in Canada and Mexico beyond investment arbitration under the USMCA.

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1. A U.S. or Mexican investor can also use this mechanism to bring an investment arbitration claim under Chapter 17 on Financial Services, subject to similar limitations on the type of claims available (Chapter 17, Annex 17-C, paragraph 2). There are, however, some differences in the procedures that a would-be claimant must follow.

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