ON**POINT** / A legal update from the International Arbitration Group

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USMCA Scales Back on Investor-State Arbitration but Preserves Trade Dispute Resolution in North America

The United States, Canada and Mexico on September 30 announced the framework for a new, revised trade agreement to replace NAFTA, called the United States-Mexico-Canada Agreement (the “USMCA”).[1]

The draft USMCA leaves the NAFTA trade dispute resolution procedures largely intact. However, it proposes several major changes to the U.S.-Canada-Mexico investment arbitration framework. If the USMCA enters into force in its current form (which is not assured), it will sharply curtail investment arbitration among the member states and eliminate it entirely between the U.S. and Canada.

Since USMCA was announced, we have received a number of inquiries on the effect of the agreement on investor-state arbitration, how to prepare for the changes and what aspects of NAFTA’s dispute resolution have remained in place. In this article, we analyze some of the issues that are relevant to investors and conclude with a list of practical action items that cross-border North American businesses need to consider ahead of USMCA’s potential implementation.

I. Entry into Force

For the USMCA to enter into force, it must first be signed by the parties, which is expected before the end of November. The timeline for the subsequent steps is less certain. Following signature, the parties must then complete their internal legislative review processes, approve the agreement, and then notify the other parties. The USMCA will become effective three months after the final notification. The parties will have to separately withdraw from NAFTA according to its withdrawal procedures.

The U.S. is most likely to be the source of delay for the USMCA. For the U.S., the agreement must be approved by Congress, which is unlikely to occur before the mid-term elections in November 2018. The timing will be affected by the outcome of the mid-term elections, the pace at which existing laws that implement NAFTA are repealed or amended, and the debate over the U.S. Executive Branch’s power to withdraw from NAFTA.

The approval process should be more straightforward in Mexico and Canada. The incoming President of Mexico has indicated that he will not renegotiate the deal, and his backing makes it likely that the agreement will be approved. While there is some political pushback in Canada, the agreement is expected to be approved by the Canadian Parliament in the coming months.

II. Effect on Investor-State Arbitration

Should the USMCA enter into force, existing NAFTA claims that have already been notified or commenced will remain unaffected, and investor-state arbitration through the old NAFTA system will remain available for three years after NAFTA’s termination for “legacy investments” (i.e., investments made in the period from when NAFTA came into force until the date when it is ultimately terminated).

USMCA's Effect on U.S.-Canada and Mexico-Canada Investment Disputes

As currently drafted, the USMCA will eliminate all investor-state arbitration initiated by Canadian investors in the U.S. and Mexico, and by U.S. and Mexican investors in Canada, save for (i) any arbitrations that have already commenced under the NAFTA framework by the date of NAFTA's termination and (ii) any arbitrations commenced regarding legacy investments within the three year sunset period. U.S. investors in Canada and Canadian investors in the U.S. will only find recourse in national courts or through state-to-state arbitration.

By contrast, Canadian investors in Mexico and Mexican investors in Canada are expected to be able to access investment arbitration through the Comprehensive and Progressive Trans-Pacific Partnership ("CPTPP") once it enters into force. The CPTPP was signed in March of this year, but has not yet been ratified. The CPTPP will enter into force sixty days after ratification by at least six of the eleven signatories. So far, only three signatories have ratified the agreement.

Effect on U.S.-Mexico Investment Disputes

If the USMCA enters into force, U.S. investors in Mexico and Mexican investors in the U.S. will still have access to investor-state arbitration under the USMCA. However, the types of claims these investors will be able to bring are more limited than those currently available under NAFTA Chapter 11 and under most investment treaties. Investors will still be able to bring the following claims:

- National treatment claims – arising from a host state providing less favorable treatment to foreign investors than that afforded to its own nationals;
- Most favored nation ("MFN") treatment claims – arising from a host state providing less favorable treatment to an investor than that afforded to another foreign investor; and
- Direct expropriation – arising from a host state nationalizing an investment.

However, investors will be unable to bring (1) national treatment and MFN claims related to the establishment or acquisition of an investment and (2) fair and equitable treatment, indirect expropriation, and other claims formerly provided for in Chapter 11, except if disputes arose under or in relation to certain government contracts (discussed further below).

Additional Changes

Other notable changes in the USMCA to the investor-state arbitration system and investment generally include the following:

- The USMCA imposes a more stringent local remedies requirement than NAFTA. Investors will first have to seek recourse in the respondent's domestic courts, and then wait until a final decision is rendered by a court of last resort or wait 30 months from the commencement of the action.
- The overall time limit for bringing claims under the USMCA will be four years from when the breach and loss becomes known to the claimant. NAFTA provides for a three year limit.
- Under the USMCA, arbitrations could be seated in any state that has ratified the New York Convention. NAFTA requires a seat in a NAFTA state.
- Under the new USMCA framework, many of the parties' submissions will be made public immediately after they are filed, as well as the transcripts of hearings, and orders, awards, and decisions of the tribunal. Hearings will also be open to the public, although the tribunal could make appropriate arrangements to protect information. NAFTA's only provision about the transparency of the arbitral proceedings is limited to the publication of awards.
- The USMCA largely adopts the definition of "investment" contained in the U.S. Model BIT, which is more general than the NAFTA definition. However, the USMCA lists certain assets that do not constitute an "investment," including orders or judgments entered in a judicial or administrative action and claims to money deriving from contracts for the sale of goods and services and associated credit.
- The USMCA defines "claimant" in a way that excludes Mexican and U.S. investments that are owned or controlled by a non-party that the other parties consider to be a non-market economy. While NAFTA contains a similar clause that restricts non-party owned investments from acting as claimants where the non-party does not have substantial business activity in the state in which it is incorporated, the USMCA will restrict non-parties from doing so even where they have substantial business activity in the state.

- The USMCA will recognize Mexico's direct, inalienable and imprescriptible ownership of all hydrocarbons in its subsoil. This may affect investment by foreign investors in oil projects, but would not necessarily bar foreign investors from producing oil in Mexico.

Under the USMCA, a subset of claims arising out of certain government contracts will not be subject to some of the new restrictions applicable to U.S.-Mexico investment protection. Investors with a covered government contract in certain sectors, including oil and gas, power generation, transportation, infrastructure, and telecommunications, will be able to pursue a broader range of claims through arbitration, including indirect expropriation and fair and equitable treatment claims. They will only be subject to a six month waiting period and will not be required to resort to domestic courts. However, they will be subject to a three year time limit for submitting claims.

III. Trade and State-to-State Dispute Resolution Procedures Remain Intact

The NAFTA Chapter 19 dispute resolution mechanism, which provides for binational panels to hear challenges to antidumping and countervailing duties, remains essentially untouched by the USMCA. The inclusion of a trade dispute resolution mechanism in the USCMA will continue to be important for Canadian and Mexican importers. While antidumping and countervailing duties can be challenged in the domestic courts of the country imposing the duties, U.S. legal proceedings involving such matters tend to favor the U.S. industry that has petitioned for the duties. Further, the NAFTA Chapter 19, and now USCMA, procedures have the force of law in the United States and thus can be enforced in domestic courts (in contrast to WTO rulings).

The USMCA will also preserve the state-to-state dispute mechanism of NAFTA Chapter 20, which provides for binational panels of experts to determine whether a member state has violated its obligations under the trade agreement. As the U.S. government increases its use of antidumping and countervailing duties as well as other special tariffs against its North American trading partners, these dispute resolution mechanisms under the USCMA could become more active.

IV. Conclusion

Under the USMCA, importers and exporters of goods will still have recourse to challenge trade measures through binational panels, but investors should reevaluate their available protections in light of the potential new regime. Specifically, investors in North America should review and rely on the following checklist of action items in anticipation of the potential implementation of the USMCA:

- Monitor USMCA developments – Investors should monitor the progress of the USMCA toward entry into force in order to respond in a timely fashion. They may consider checking the following government websites for updates regarding specific party's signing and approval of the agreement:
    - United States -- https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement
    - Canada -- https://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/usmca-aeumc/index.aspx?lang=eng
    - Mexico -- https://www.gob.mx/tlcan
- Monitor CPTPP developments – Canadian investors in Mexico and Mexican investors in Canada should monitor progress toward the entry into force of this agreement between Canada and Mexico, providing investment arbitration for those investors. Mexico has already ratified the CPTPP, but Canada has not. Entry into force between Mexico and Canada will require Canada's approval plus that of at least two other governments.
- Agreement planning – Investors should consider how to best structure new investments that may arise under the USMCA framework in order to maximize agreement protection of those investments. Investors may consider structuring their investments through jurisdictions which provide them with maximum agreement protection. Investors in North America should carefully consider tax implications when structuring new investments.
- Contract planning – Investors should assess the possibility of concluding contracts with the relevant governments that contain arbitration clauses that, potentially, permit claims concerning the protections in the USMCA. Investors with investments between the U.S. and Mexico should additionally consider whether they can enter into government contracts related to their investment, thereby allowing for investment arbitration of a greater range of investment protections under the USMCA.
- Pending claims – Investors will have three years following the termination of NAFTA to commence any claims for disputes regarding legacy investments under the NAFTA framework. Host states and foreign

investors should assess when an investment can be said to have been made and when a possible investor-state arbitration dispute can be said to have materialized, in order to determine whether a particular claim is covered by NAFTA or will fall under the regime that is foreseen in the USMCA, or potentially both.

Dechert has an experienced team of arbitration, litigation, trade and tax specialists who can assist you with understanding, pursuing and defending claims that may arise under the USMCA should it enter into effect, as well as with structuring investments to maximize protection under the proposed USMCA framework.

Footnotes

1) For a discussion of the trade-related changes from NAFTA impacting the automotive sector, please see Dechert's OnPoint, USMCA: Major Impact on Automotive Supply Chain Management.

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