

LIMITATIONS ON THE SCOPE OF INVESTOR-STATE DISPUTE SETTLEMENT UNDER THE UNITED STATES-MEXICO-CANADA AGREEMENT

On 30 September 2018, the United States, Mexico, and Canada announced their agreement on a replacement for the North American Free Trade Agreement ("**NAFTA**"), which has been in force since 1994. The updated agreement modernizes and substantially amends certain aspects of NAFTA and will be called the United States-Mexico-Canada Agreement ("**USMCA**").

Chapter 14 of the USMCA provides the new framework for investor-state dispute settlement ("**ISDS**") and replaces Chapter 11 of NAFTA. The new chapter envisages important changes to the NAFTA ISDS provisions. In particular, the ISDS provisions under the USMCA do not apply to Canada. ISDS remains available for US-Mexico investment disputes, although the scope of available recourse is significantly limited. In another important shift away from NAFTA Chapter 11, the USMCA also pares back the scope of protection afforded to investors.

The Parties are expected to sign the USMCA by the end of November 2018. Once signed, under Trade Promotion Authority legislation, several procedural steps must be taken prior to the USMCA's approval and coming into force. Under Chapter 14, "legacy" claims concerning investments made under NAFTA will remain available to protected investors for a 3-year period following the termination of NAFTA.¹

MORE LIMITED ACCESS TO ISDS UNDER THE USMCA

Investment Disputes Involving Canada

Under Chapter 14, US investors in Canada and Canadian investors in the United States will no longer have recourse to ISDS for breaches of investment protections. Canada's reluctance to champion the survival of the NAFTA ISDS provisions is perhaps unsurprising, given that it has been on the receiving end of numerous successful NAFTA Chapter 11 claims.

As between Canada and Mexico, investors may potentially rely on the ISDS provisions in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("**CPTPP**") once it comes into force; the United States withdrew from the precursor Trans-Pacific Partnership in 2017.

US-Mexico Investment Disputes

While ISDS will continue to be available for US-Mexico investment disputes, claims will generally be limited to (i) breach of the National Treatment or Most-

¹ Chapter 14, Annex 14-C, Legacy Investment Claims and Pending Claims, paragraph 3

Favored-Nation treatment obligations, or (ii) direct expropriation.² In certain "covered sectors"—oil and gas, power generation services, telecommunications, transportation, and specified types of infrastructure projects—the USMCA grants wider ISDS protections (e.g., to bring claims for indirect expropriation or failure to accord fair and equitable treatment) to certain investments related to "covered government contracts".³

The USMCA also places more stringent demands on investors before claims not related to covered government contracts can be brought under Chapter 14. Prior to submitting such a claim, an investor must first initiate a proceeding before a competent court or administrative tribunal of the respondent with respect to the alleged measures and wait until either it has obtained a final decision from a court of last resort or 30 months have elapsed from the date the proceeding was started.⁴ Notably, Chapter 14 restricts claims from being brought in relation to the establishment or acquisition of an investment.⁵

In another development, the USMCA excludes claims by any investor that is "owned or controlled by" an entity that the respondent considers to be a "non-market economy," thereby potentially limiting claims in relation to investments owned indirectly by, for example, Chinese companies.⁶

NARROWING OF THE SUBSTANTIVE STANDARDS OF PROTECTION UNDER THE USMCA

The USMCA elaborates upon a number of key substantive protections, for purposes of providing "greater certainty" about their content. For example, in relation to the National Treatment and Most-Favored-Nation Treatment standards, the USMCA states that the question of whether treatment is accorded in "like circumstances" will depend on "the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives."⁷

Similarly, the Minimum Standard of Treatment provisions specifically limit the "fair and equitable treatment" ("FET") and "full protection and security" obligations by reference to the customary international law minimum standard of treatment of aliens. In particular, FET is stated to "include the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings, in accordance with the principle of due process". This FET language notably mirrors several US free trade agreements (such as the Panama-US, Peru-US, and Morocco-US FTAs), as well as the Canada-Colombia Free Trade Agreement.

The USMCA also provides a more precise definition of what constitutes an indirect expropriation stating that each case "requires a case-by-case, fact-based inquiry" that considers a number of factors, including "the extent to which the government action interferes with distinct, reasonable investment-backed expectations."⁸ In turn, the question of whether an investor's investment-backed expectations are reasonable will depend on factors such as whether the

² Chapter 14, Annex 14-D, Mexico-United States Investment Disputes, Article 3

³ Chapter 14, Annex 14-E, Mexico-United States Investment Disputes Related to Covered Government Contracts, Article 6

⁴ Chapter 14, Annex 14-D, Mexico-United States Investment Disputes, Article 5(1)(b)

⁵ Chapter 14, Annex 14-D, Mexico-United States Investment Disputes, Article 3(1)(b)(i)(A)

⁶ Chapter 14, Annex 14-D, Mexico-United States Investment Disputes, Article 1

⁷ Chapter 14, Articles 14.4(4) and 14.5(4)

⁸ Chapter 14, Annex 14-B, Expropriation, Article 3(a)(ii)

government provided the investor with "binding written assurances and the nature and extent of governmental regulation or the potential for government regulation in the relevant sector."⁹ This test may present a high bar for an investor to meet.

Arguably, this move towards increased elaboration of relevant standards of protection reflects the wider international trend of States clarifying the scope of investment protections and providing direction about the balance to be achieved between investors' rights and the right to regulate in the public interest.

Once the USMCA applies, investors in North America who have traditionally relied on NAFTA's investment protections will need to re-evaluate their options for protecting their investments. In particular, investors should be ready potentially to pursue their claims in national courts or to consider the availability of investment protections through other agreements such as the CPTPP. Investors in other markets—in particular those with which the Trump Administration has indicated an interest in negotiating a trade agreement, such as Japan—should be prepared for a similar approach to ISDS to that in the USMCA.

⁹ Chapter 14, Annex 14-B, Expropriation, Article 3(a)(ii)

CONTACTS



Audley Sheppard
Partner

T: +44 207006 8723
E: audley.sheppard
@cliffordchance.com



Jason Fry
Partner

T: +33 1 4405 5303
E: jason.fry
@cliffordchance.com



**Ignacio Suarez
Anzorena**
Partner

T: +1 202 912 5185
E: ignacio.suarezanzorena
@cliffordchance.com



Janet Whittaker
Partner

T: +44 207006 2821
E: janet.whittaker
@cliffordchance.com



Louis Alexis Bret
Lawyer

T: +33 1 4405 5253
E: louisalexis.bret
@cliffordchance.com



Jose Garcia Cueto
Lawyer

T: +1 202 912 5123
E: jose.garciacueto
@cliffordchance.com



Minty Hamer
Trainee Solicitor

T: +33 1 4405 5355
E: minty.hamer
@cliffordchance.com

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www.cliffordchance.com

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London, E14 5JJ

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