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International Arbitration Focus Team

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The United States, Mexico and Canada Agreement ("USMCA")

International Arbitration Focus Team

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With the ratification process now complete, the USMCA is set to enter into force on July 1, 2020.

The USMCA contains 34 Chapters, which comprehensively cover trade and investment matters. Chapter 14 concerns the protection of investments and will replace NAFTA Chapter 11.

Compared to NAFTA, the USMCA offers less protections to investors. Whereas, in some areas, the USMCA merely codifies principles and rules developed under NAFTA, under other aspects, notably dispute resolution, it introduces restrictions and limitations that NAFTA did not contain (e.g., the limited scope of the claims that are subject to arbitration and the mandatory pre-arbitration court proceedings). In the same vein, the USMCA balances investment protection with the host State's right to regulate and promote public welfare, health, safety and environmental protection, and clarifies the nature of investors' legitimate expectations.

Below we highlight the main features of the USMCA Chapter 14.

The "investments" and the "investors" protected under the USMCA

The USMCA protects "every asset" owned or controlled, directly or indirectly, by an investor, which has the features of an investment, including "the commitment of capital or other resources," "the expectation of gain or profit," and "the assumption of risk." The list of examples includes the most common types of assets, but expressly excludes claims to money arising solely from sales and services contracts and commercial credit. Non-profit investments that have no "expectation of gain or profit" are apparently excluded.

Protected investors are nationals or enterprises of a Contracting Party that attempt to make, are making, or have made an investment in the territory of another Party. A Contracting Party may deny the USMCA benefits to an investor that is an enterprise of another Party if the enterprise is owned or controlled by a person of a non-Party or of the denying Party that has no substantial business activities in the territory of any Party except for

the denying Party.

Standards of treatment

The USMCA provides for National Treatment (NT) and Most-Favored-Nation Treatment (MFNT), Minimum Standard of Treatment (MST), compensation in the event of expropriation or losses due to armed conflict or civil strife, free transfer of capitals and prohibition of performance requirements. The scope of these standards of treatment is comparable to those under NAFTA, but some are more narrowly framed and grant less protection than most investment protection treaties.

Specifically, the MST is limited to the customary international law minimum standard of treatment of aliens. This includes the concepts of "fair and equitable treatment" and "full protection and security" standards, which are normally present in investment protection treaties and which cover a broad range of State conduct harmful to investors, including the violation of the investor's legitimate expectations. However, under the USMCA, they are not intended to provide broader protections or to create additional rights than minimum standard. Indeed, the USMCA cites examples of basic violations of the MST, such as denial of justice, violation of due process and failure to provide police protection in accordance with customary law. Likewise, State actions that are inconsistent with an investor's expectations do not constitute, in and of themselves, a breach of the USMCA.

The NT and MFNT apply at both the federal and the sub-federal level, but only within the same level: thus, an investor that made an investment in a given State or Province cannot complain that another State or Province provides more favorable treatment. The assessment of "like circumstances" in case of discrimination must consider the totality of the circumstances, including whether any distinctions in treatment were based on "legitimate public welfare objectives". The applicability of the MFNT to dispute settlement is expressly excluded.

Expropriation includes all types of deprivation of property, whether direct, indirect or creeping. Notably, non-discriminatory regulatory measures aimed at protecting legitimate public welfare objectives, such as health, safety and environment, may constitute indirect expropriation only "in rare circumstances". The USMCA clarifies that a substantial interference with the investor's rights or reasonable expectations is required for a finding of expropriation, and expectations are deemed reasonable based on factors such as the existence of binding written assurances by the Government, the nature and extent of governmental regulation and the potential for government regulation in the relevant sector. These clarifications, which in part reflect precedents set in previous NAFTA cases, narrow the scope of indirect expropriation.

Dispute settlement

The limited availability of diagonal arbitration is a distinguishing feature of USMCA Chapter 14. Unlike NAFTA Chapter 11, investors are not entitled to resort to arbitration for any violation of any standards of treatment, but only in relation to narrow classes of disputes. Canadian investors are excluded altogether from most of them because Canada consented to submit to arbitration only disputes related to "legacy investments."

First, arbitration is generally available only to United States and Mexican investors and only in case of violation of the NT and the MFNT standards (excluding disputes concerning the establishment and acquisition of an investment) and direct expropriation. Indirect expropriation and violations of MST which, based on experience, are likely to be the most common, cannot form the basis for an arbitration claim.

Before starting arbitration, investors are required to resort to the host State's courts for up to 30 months, unless doing so would be obviously futile. A four-year limitations period applies.

The Secretary-General of ICSID acts as appointing authority and the rules on conflicts of interest applicable to arbitrators are particularly strict – for instance, for the duration of the arbitration, arbitrators must refrain from acting as counsel or as party-appointed experts or witnesses in any other arbitration under the USMCA.

Second, under Annex 14-E, United States and Mexican investors are entitled to bring claims for the violation of any standard of treatment under Chapter 14, if they, or a local company that they own and control, are party to a "Government Contract" entered into with a State authority of the host State in a covered sector (i.e., oil and gas, power generation, telecommunications, transportation and concessions). Concessions and licenses granted unilaterally by the host State do not constitute "Government Contracts." The limitations period for these claims is three years and arbitration will be available as long as the respondent State remains party to other investment agreements providing for investor-State arbitration.

Finally, investors still have **three years** to bring claims to arbitration under NAFTA, but only in relation to investments made between January 1st, 1994 and the date of termination of NAFTA that are in existence on that date ("legacy investments"). United States and Mexican investors cannot bring such claims if they are eligible to submit them to arbitration under Annex 14-E above.

International Arbitration Focus Team

The Focus Team is a constellation of skills in different practice areas with a focus on International Arbitration.

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