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Legacy NAFTA Investor Protections to Expire in 2023

NAFTA's "Sunset Period" for Private Investors to Pursue Claims in Arbitration Will end as of July 1, 2023.

SUMMARY

In 2020, the United States-Mexico-Canada Agreement ("USMCA") entered into force, replacing the 1994 North American Free Trade Agreement ("NAFTA"). Both treaties include certain protections that the contracting states must afford to nationals of the other contracting states investing in their territory, and provide for arbitration as a forum to recover losses from breaches of those protections. However, USMCA contains additional limitations and restrictions on foreign investors' rights to pursue claims in arbitration for breach of the treaty's terms. Under Annex 14-C of USMCA, claims related to foreign investments established or acquired while NAFTA was in place (so-called "Legacy Investments") may still be submitted to arbitration under the NAFTA regime for a "sunset" period of three years, which ends on July 1, 2023.

In practice, given NAFTA's requirement that investors give advance notice to the host state and in some circumstances comply with other conditions prior to the commencement of an arbitration, investors with potential claims under NAFTA will have to act well before June 30, 2023 or risk the loss of those claims. In addition, unlike NAFTA, Canada has not signed the investor-state dispute resolution portions of USMCA. Accordingly, Canadian investors in Mexico and the United States, and Mexican and U.S. investors in Canada, do not have access to arbitration to resolve their USMCA disputes.

With NAFTA's "sunset period" lapsing next year, qualifying foreign investors should carefully consider whether they have claims under NAFTA, and whether those claims should be pursued.

INVESTMENT ARBITRATION UNDER NAFTA AND USMCA

NAFTA entered into force in January 1994 and provides for arbitration of claims brought by investors of one of the signatory states (*i.e.*, Canada, Mexico and the United States) against another signatory state for losses caused by breaches of the treaty's investment protections. Those protections include obligations of signatory host states to afford investors from the other signatories, *inter alia*, fair and equitable treatment,[1] full protection and security,[2] protection against expropriation without adequate compensation, national treatment equivalent to domestic investors,[3] and most favored nation treatment.[4] NAFTA provides several pre-arbitration procedures, including a pre-arbitration notice and efforts to try to resolve the dispute with the respective government. Since 1994, there have been more than 70 reported arbitrations brought under NAFTA.[5]

USMCA entered into force on July 1, 2020, replacing NAFTA. However, USMCA provides a sunset period for investors with Legacy Investments—*i.e.*, investments made between January 1, 1994 and June 30, 2020—to pursue claims under NAFTA. This sunset clause has certain limitations, and does not benefit U.S. and Mexican investors who can bring their claims under USMCA Annex 14-E's more favorable arbitration procedures (described below).[6]

While on their face the substantive standards of protection benefiting foreign investors remain largely unchanged in USMCA (with certain limited scope modifications), the right to access arbitration as a remedy for breaches of those obligations is generally viewed to be more limited than NAFTA.

First, unlike NAFTA, Canada is not a party to USMCA's investor-state dispute settlement mechanism. Accordingly, Canadian investors in Mexico and the United States, as well as Mexican and U.S. investors in Canada, will no longer enjoy the right they had under NAFTA to pursue arbitration for violations of the standards of protection set out in the treaty. While Canadian and Mexican investors may be able to rely on other investment treaties between those two nations,[7] the expiration of NAFTA means that Canadian investors in the United States and U.S. investors in Canada, will no longer have access to such remedies against the state in which they have invested.

Second, unlike NAFTA, USMCA creates a two-tier regime that determines eligibility to bring arbitration claims based on the type of investments an investor has made. In particular, investors with claims arising out of "covered government contracts" ("Privileged Investors") maintain the right to pursue claims in arbitration for breaches of all of the substantive investment protections set out in the USMCA, while other investors have more limited arbitration rights ("Non-Privileged Investors").[8] A "covered government contract" is defined as (i) "a written agreement with a national authority of an Annex Party (*i.e.*, Mexico or the United States) and a covered investment or investor of the other Annex Party"[9] (ii) in the oil and natural gas, power generation, telecommunications, transportation, or infrastructure sectors.[10] Notably, some

Privileged Investors may not be able to avail themselves of the right to bring legacy NAFTA claims during the sunset period, as USMCA expressly bars legacy NAFTA claims from Mexican or U.S. investors that otherwise qualify for a claim under USMCA Annex 14-E (Mexico-United States Investment Disputes Related to Covered Government Contracts).[11]

Unlike Privileged Investors with covered government contracts, Non-Privileged Investors may access arbitration under the USMCA only for claims of direct expropriation[12] or violations of the national-treatment and most-favored-nation obligations (the latter two of which are aimed at preventing discrimination in favor of the host state's or other foreign nationals). Notably, claims for breach of the national treatment and most favored nation standards by Non-Privileged Investors are subject to a broad exception for claims that relate to "the establishment or acquisition of an investment." This means, as a practical matter, that a state may be able to impose some conditions to an initial foreign investment, although the treaty does not define when an investment is "established" or "acquired." Additionally, Non-Privileged Investors cannot pursue an investor-state arbitration claim for the violation of the minimum standard of treatment under customary international law (which includes the obligation to afford investors fair and equitable treatment), and therefore will have to rely on domestic law remedies of the host country when challenging measures affecting their investment.[13] Further, Non-Privileged Investors bringing an arbitration claim must first exhaust domestic law remedies until obtaining a final decision or for at least 30 months.[14]

IMPLICATIONS

With the pending expiration of NAFTA's sunset period in June 2023, investors in Canada, Mexico, and the United States that have been subject to government action that may violate the treaty's substantive investor protections should carefully consider whether they have a claim under NAFTA, and whether USMCA will provide a viable alternative path to recover any losses. In doing so, investors should take into account (a) whether they have a USMCA covered government contract, (b) the nationality of the qualifying investor and location of the investment, and (c) whether the host country's actions may amount to the breach of one of the USMCA's substantive protections.

Investors with a viable NAFTA claim that has not yet been pursued must act promptly or risk either losing the right to pursue that claim or being forced to pursue it through USMCA's potentially less favorable regime for Non-Privileged Investors. In addition, NAFTA requires certain pre-arbitration notice and imposes other conditions in certain circumstances. For example, an investor must provide the host country notice of intent to initiate an arbitration at least 90 days prior to doing so.[15] Investors with expropriation claims related to taxation measures have additional pre-arbitration conditions that must be met, including submission of their

claim to the national tax authorities of both the investment's host country and of the investor's country of origin for review at least six months before commencing arbitration.

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ENDNOTES

[1] The "fair and equitable treatment" or "FET" standard may encompass, *inter alia*, denial of due process, denial of justice, non-observance or frustration of investors' legitimate expectations, coercion and harassment by the organs of a host State, failure to offer a stable and predictable legal framework, absence of transparency, and arbitrary and discriminatory treatment. The precise nature and scope of the standard has been the subject of abundant international investment case law. *See*, *inter alia*, *Técnicas Medioambientales Tecmed, S.A.* v. *United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003; *Sevilla Beheer B.V. and others* v. *Kingdom of Spain*, ICSID Case No. ARB/16/27, Decision on Jurisdiction, Liability and the Principles of Quantum, February 11, 2022; *Pawlowski AG and Project Sever s.r.o.* v. *Czech Republic*, ICSID Case No. ARB/17/11, Award, November 1, 2021.

[2] The "full protection and security" standard protects against the host State's failure to provide for the safety and protection of an investment, which can happen either through acts of State organs or acts otherwise attributable to the State under international law, or through the host State's failure to protect investors and investments against actions of third parties within its jurisdiction. Again, the standard has been discussed in numerous arbitral awards. *See*, *inter alia*, *Hydro Energy 1 S.à r.l. and Hydroxana Sweden AB* v. *Kingdom of Spain*, ICSID Case No. ARB/15/42, Decision on Jurisdiction, Liability and Directions on Quantum, March 9, 2020; *South American Silver Limited* v. *The Plurinational State of Bolivia*, PCA Case No. 2013-15, Award, November 22, 2018; *Mamidoil Jetoil Greek Petroleum Products Societe Anonyme S.A.* v. *Republic of Albania*, ICSID Case No. ARB/11/24, Award, March 30, 2015.

[3] The "national treatment" standard requires host States to accord foreign investors and investments treatment no less favorable than they accord to domestic investors and their investments. *See, e.g.*, *South American Silver Limited* v. *The Plurinational State of Bolivia*, PCA Case No. 2013-15, Award, November 22, 2018; *Casinos Austria International GmbH and Casinos Austria Aktiengesellschaft* v. *Argentine Republic*, ICSID Case No. ARB/14/32, Decision on Jurisdiction, June 29, 2018; *Olin Holdings Limited* v. *State of Libya*, ICC Case No. 20355/MCP, Award, May 25, 2018.

[4] The "most favored nation" or "MFN" standard requires that States party to the investment treaty accord investors and their investments a treatment no less favorable than the treatment they accord to the investors and investments of other States. *See*, *e.g.*, *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S.* v. *Islamic Republic of Pakistan* (I), ICSID Case No. ARB/03/29, Award, August 27, 2009; *Parkerings-Compagniet AS* v. *Republic of Lithuania*, ICSID Case No. ARB/05/8, Award, September 11, 2007.

[5] *See* Investment Policy Hub, "Investment Dispute Settlement Navigator – Treaties with Investment Protections - NAFTA", *available at* https://investmentpolicy.unctad.org/investment-dispute-settlement (last accessed October 26, 2022).

[6] *See* USMCA Annex 14-C(1)(c), footnote 21.

[7] Canada and Mexico are parties to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, which includes provisions on the protection of foreign investments and an investor-State arbitration mechanism. *See* Comprehensive and Progressive Agreement for Trans-Pacific Partnership, Chapter 9, Section A, Arts. 9.4 (National Treatment), 9.5 (Most Favored Nation), 9.6 (Minimum Standard of Treatment), 9.8 (Expropriation and Compensation), 9.9 (Transfers), 9.20 ("Consent of Each Party to Arbitration").

[8] *See* USMCA Art. 14.2.4, and Annex 14(E)(6)(a).

[9] *Id.* Annex 14(E)(6)(a). A "National Authority" means an authority at the central level of government, which "includes any person, including a state enterprise or another body, when it exercises

ENDNOTES (CONTINUED)

governmental authority delegated to it by an authority at the central level of government." *Id.* Annex 14(E)(6)(c).

10 *See id.* Annex 14(E)(6)(a).

11 *See* USMCA Annex 14-C(1)(c), footnote 21.

12 *See id.* Annex 14-D, Art. 14(D)(3)(1)(a)(i)(b). Generally under USMCA, a direct expropriation occurs where "an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure," whereas indirect expropriation occurs where "an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure." USMCA Annex 14-B(1) and (2).

13 *See id.* Annex 14-D, Art. 14(D)(3)(1)(a)(i)(a) and (b).

14 *See id.* Annex 14-D, Art. 14(D)(5)(1)(b).

15 *See* USMCA Chapter 31, Art. 31.2. Mirroring NAFTA, USMCA requires the investor to serve the host State with a Notice of Dispute, which triggers a 90-day period of mandatory consultations and negotiations (*see* USMCA Annex 14-D, Art. 14.D.3.2). Additionally, as under NAFTA, USMCA provides that when an expropriation claim implicates "taxation measures," the competent fiscal authorities of the investment's host State and of the investor's home State may block arbitration. An investor must refer the issue of whether a taxation measure is or is not an expropriation to the competent authorities of the investor's home State and the host State at the same time it gives notice of its intent to submit a claim to arbitration. Only after the competent authorities decline to consider the issue or fail to make a determination within a period of six months from the referral, may the investor formally submit the claim to arbitration (*see* USMCA Art. 32.3.8).

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