From NAFTA to USMCA: Main Changes to the Investor-State Dispute Settlement System

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The United States-Mexico-Canada Agreement (the "USMCA") will enter into force on July 1, 2020, replacing the North American Free Trade Agreement ("NAFTA"). The USMCA's Investment Chapter has several significant differences from the NAFTA regime of which investors should be aware.

Canada Is Not Party to the USMCA's Investor-State Dispute Settlement ("ISDS") Provisions. Under the USMCA, investor-State arbitration is limited to the United States and Mexico. Because there are no other investment agreements with ISDS provisions in force between the United States and Canada, investors from Canada or the United States will not have access to investor-State dispute resolution against those countries. Access to ISDS for disputes between Canadian or Mexican investors and Mexico or Canada, respectively, will be possible under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (the "CPTPP"), which entered into force on December 30, 2018, but not under the USMCA.

Privileged Regime for Government Contracts in "Covered Sectors". Under the USMCA a privileged regime applies to foreign investors that are "party to a covered government contract" and belong to five "covered sectors": (i) oil and gas; (ii) power generation; (iii) telecommunications; (iv) transportation; and (v) infrastructure. Investors under this privileged regime can enforce substantially the same investment protections available under NAFTA through the USMCA's ISDS procedures. Likewise, largely the same jurisdictional hurdles and waiting periods that applied under NAFTA will apply under the USMCA to privileged disputes.

Nonprivileged Regime for All Other Disputes. A less favorable regime applies to all other foreign investors under the USMCA. The main limitations applicable to nonprivileged disputes are the following:

- **Limited Access to Investor-State Arbitration.** Nonprivileged investors can only access the USMCA's ISDS system to enforce claims for (i) direct expropriation and (ii) national treatment and most favored nation treatment (principle of nondiscrimination), with the broad exception of claims on "the establishment or

acquisition of an investment." Claims for indirect expropriation (substantial interference without a direct taking of property) and minimum standard of treatment—which includes fair and equitable treatment and full protection and security—have to be advanced by the investor's home State using the USMCA's State-to-State dispute settlement mechanism or directly brought by the investor before the host State's courts.

- **Local Litigation Requirement**. Nonprivileged investors must first obtain a final decision from the local courts of final appeal or defend their claims in local courts for 30 months before initiating arbitration, unless such action would be "obviously futile."

- **Prescription Period**. Nonprivileged investors must submit their claims to arbitration within four years of having acquired either actual or constructive knowledge of the host State's breach and the loss or damage incurred. Given the 30-month requirement to litigate before local courts, in practice this limitation means that investors who are not part of the privileged regime have only 18 months to submit their claims to national courts.

Double-hatting and Transparency. The USMCA also includes updated provisions on panel selection and transparency applicable to all arbitrations under both the privileged and nonprivileged regimes. Notably, the USMCA forbids arbitrators from acting in another capacity in any other pending arbitration under the Agreement and requires compliance with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration. Hearings will be open to the public, and parties' submissions, transcripts of hearings, orders, awards and decisions of the tribunal will be made public after the tribunal makes the appropriate arrangements to protect any confidential or privileged information.

Pending NAFTA Arbitrations and Legacy Investments. The USMCA will not affect ongoing NAFTA arbitrations. In addition, investors will be able to file new NAFTA claims within three years of NAFTA's termination, provided the dispute arises out of "legacy investments"—that is, investments that were "established or acquired" when NAFTA was still in force and that remained "in existence" on the date the USMCA entered into force. As noted, after the three-year window for NAFTA-protected legacy investments expires, there will no longer be an ISDS system between Canada and the United States.

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Due to the fewer treaty protections enforceable through ISDS and heightened preconditions to arbitrate applicable to nonprivileged investors under the USMCA,

companies that fall under this regime should consider filing potential NAFTA claims before the three-year window for legacy investments expires. Companies not part of the privileged regime should also consider reviewing their investment structuring so as to maximize access to robust treaty protections, including access to international arbitration.

If you have any questions about how the forthcoming changes will affect your business, please contact the authors below.


Catherine Amirfar
camirfar@debevoise.com


Donald Francis Donovan
dfdonovan@debevoise.com


Mark W. Friedman
mwfriedman@debevoise.com


Lord Goldsmith QC
phgoldsmith@debevoise.com


Ina C. Popova
ipopova@debevoise.com


Dietmar W. Prager
dwprager@debevoise.com


Natalie L. Reid
nlreid@debevoise.com


David W. Rivkin
dwrivkin@debevoise.com


Guilherme Recena Costa
grecenacosta@debevoise.com


Julio Rivera Rios
jriverar@debevoise.com


Laura Sinisterra
lsinisterra@debevoise.com