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# NAFTA AND THE USMCA: THE SUBSTANTIAL DIFFERENCES

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## I. INTRODUCTION

The North American Free Trade Agreement (NAFTA)[1] and the United States-Mexico-Canada Agreement (USMCA)[2] represent fundamental trade and arbitration agreements concluded between Mexico, the US, and Canada.[3] The treaties have been the legal instruments governing the investment rights relative to investor-state dispute settlement as well as the potential controversies that may arise between the three State signatories of the treaties. These conventions have been essential to the contemporary development of international arbitration.

On July 1, 2020, NAFTA was terminated as a result of a political controversy, based on a series of declarations made by President Trump indicating that NAFTA was the worst treaty ever signed by the US.[4] Set to officially end on July 1, 2023—when the USMCA will take its place—NAFTA will still apply beyond its termination if certain requirements provided in the USMCA are met. But it shall apply only for arbitrations filed during a "Sunset Period," between July 1, 2020—the entry into force of the USMCA—and July 1, 2023, three years after the termination of NAFTA.[5] Such a mechanism has already been invoked in thirteen cases: nine against Mexico,[6] three

[1] North American Free Trade Agreement between the Government of the United States of America, the Government of Canada and the Government of the United Mexican States, 17 December 1992, 32 I.L.M. 612 [hereinafter NAFTA].

[2] Canada-United States-Mexico Agreement ch. 14, Dec. 10, 2019, Agreement between the United States of America, the United Mexican States, and Canada, OFF. U.S. TRADE REPRESENTATIVE: FREE TRADE AGREEMENTS (Dec. 13, 2019), [hereinafter USMCA].

[3] While this article follows the US's use of the term "USMCA," Canada refers to the agreement as the Canada-United States-Mexico Agreements (CUSMA) and Mexico refers to it as the Tratado entre México, Estados Unidos y Canadá (T-MEC).

[4] Patrick Gillespie, *Trump Hammers America's 'Worst Trade Deal'*, CNN MONEY (Sept. 27, 2016), https://money.cnn.com/2016/09/27/news/economy/donald-trump-nafta-hillary-clinton-debate/index.html.

[5] USMCA, *supra* note 2, at Annex 14-C (noting that each Party's consent to submit "legacy investment claims" to arbitration under NAFTA will expire three years after the termination of NAFTA).

[6] *See* First Majestic Silver Corp. v. Mexico, ICSID Case No. ARB/21/14; *Finley Resources Inc. v. Mexico*, ICSID Case No. ARB/21/25; L1bre Holding, LLC v. Mexico, ICSID Case No. ARB/21/55; Doups v. Mexico, ICSID Case No. ARB/22/24; Amerra Capital Management LLC v. Mexico, ICSID Case No. UNCT/23/1;

against Canada,[7] and one against the US.[8]

NAFTA and the USMCA have a good number of similarities but are not identical. There exist substantial differences between the two treaties. The purpose of this paper is to identify the most relevant of them and discuss the impact of those differences.

## II. SUBSTANTIAL DIFFERENCES

As an initial matter, Canada has decided not to be part of the investor-state dispute settlement (ISDS) provisions of the USMCA, as provided in its Annex 14 D and Annex E.[9] These two sections regulate investment between Mexico and the US and disputes related to covered government contracts applicable to the US and to Mexico. Thus, investors from Canada or the US will not have access to investor-State dispute settlement as between those countries. In the case of Mexico and Canada, if an investment dispute arises, resort to The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) will provide the arbitral means to settle the controversy.

### A. *The Definition of Investment*

NAFTA did not include a clear-cut definition of investment; instead, ICSID tribunals undertook this task. In contrast, the USMCA provides a very precise definition of investment, inspired to some extent by decisions of ICSID arbitral tribunals. It provides that "Investment" means:

a) Every asset that an investor owns or controls, directly or indirectly;

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Goldgroup Resources, Inc. v. Mexico, ICSID Case No. ARB/23/4; Sepavede International LLC v. Mexico, ICIS Case No. ARB/23/6; Access Business Group LLC v. Mexico, ICSID Case No. ARB/23/15; Enerflex US Holdings Inc. v. Mexico, ICSID Case No. ARB/23/22; *but see also* Coeur Mining v. Mexico, https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/1258/coeur-mining-v-mexico.

[7] *See* Koch Industries Inc. v. Canada, ICSID Case No. ARB/20/52; Windstream Energy LLC v. Canada (II), PCA Case No. 2021-26; Ruby River Capital LLC v. Canada, ICSID Case No. ARB/23/5.

[8] *See* TC Energy Corp. v. US, ICSID Case No. ARB/21/63.

[9] USMCA, *supra* note 2, at Annex 14-D.1 (defining "Annex Party" as Mexico or the United States, but not Canada); USMCA, *supra* note 2, at Annex 14-E (using the definition of Annex Party from Annex 14-D).

b) That has the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gains or profits, or the assumption of risk.[10]

The USMCA provides a long and detailed list of items that may be considered as investment, similar but not identical to the NAFTA list, and some items that do not fall under the definition of investment.[11]

*B. The Issue of Covered Sectors*

Under the USMCA, a privileged group of US or Mexican investors who possess a covered government contract and that operate in a covered sector, enjoy a strong and extensive protection in terms of both procedure and material investment claims.

To qualify as a member of this elite group of investors, the investment must operate in one of the five covered sectors: (i) oil and gas activities; (ii) public power generation services; (iii) public telecommunications services; (iv) public transportation services; or (v) infrastructure.[12]

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[10] USMCA, *supra* note 2, Article 14.1.

[11] *Compare* NAFTA, *supra* note 1, Article 1139 *with* USMCA Article 14.1:

> … investment means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. An investment may include:
>
> (a) an enterprise; (b) shares, stock and other forms of equity participation in an enterprise; (c) bonds, debentures, other debt instruments, and loans; (d) futures, options, and other derivatives; (e) turnkey, construction, management, production, concession, revenue-sharing, and other similar contracts; (f) intellectual property rights; (g) licenses, authorizations, permits, and similar rights conferred pursuant to a Party's law; and (h) other tangible or intangible, movable or immovable property, and related property rights, such as liens, mortgages, pledges, and leases,
>
> but investment does not mean:
>
> (i) an order or judgment entered in a judicial or administrative action; (j) claims to money that arise solely from: (i) commercial contracts for the sale of goods or services by a natural person or enterprise in the territory of a Party to an enterprise in the territory of another Party, or (ii) the extension of credit in connection with a commercial contract referred to in subparagraph (j)(i).

[12] USMCA, *supra* note 2, Annex E2.6(b) (defining "covered sector" as

> (i) activities with respect to oil and natural gas that a national authority of an Annex Party controls, such as exploration, extraction, refining, transportation, distribution, or sale,
>
> (ii) the supply of power generation services to the public on behalf of an Annex Party,
>
> (iii) the supply of telecommunications services to the public on behalf of an Annex Party,

Further, in order to benefit from the USMCA's protections, an investor operating in a covered sector must have a covered government contract concluded with a national authority, which means an authority at the "central level of government," as defined by the treaty itself.[13] Such a contract entitles investors to a series of substantive rights, such as a minimum standard of treatment (which includes fair and equitable treatment and full protection and security), protection against direct or indirect expropriation,[14] and exception from the requirement to exhaust local court proceedings as a prerequisite to resort to investment arbitration.[15]

But investors not belonging to the covered sector will have a less substantial protection of their rights under the USMCA than they had under NAFTA. Their investment-treaty arbitration claims will be limited to breaches of national treatment,[16] recourse to most-favored-nation treatment,[17] and to a claim of expropriation.[18] And, unlike investors belonging to the covered sector, those claims may be brought only after first successfully exhausting local remedies before local courts. Beyond their legal reach will be the right to claim a violation of a fair and equitable treatment or the existence of an indirect expropriation, now reserved for covered sector investors.

Unlike NAFTA, the USMCA considerably limits the scope of "national treatment" by applying a "like circumstances" test.[19] Thus, under the USMCA, the decision to

(iv) the supply of transportation services to the public on behalf of an Annex Party, or

(v) the ownership or management of roads, railways, bridges, or canals that are not for the exclusive or predominant use and benefit of the government of an Annex Party.).

[13] *Id.* at Annex 14-E.6(c).

[14] *Id.* at Article 14.D.3.

[15] *Compare id.* at Article 14.D.5.1 *with* Annex 14-E.4.

[16] *Id.* at Article 14.4.

[17] *Id.* at Article 14.5.

[18] *Id.* at Article 14.4.

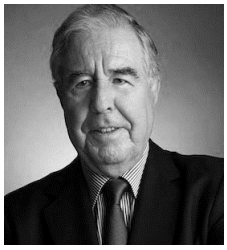
[19] *Compare* NAFTA, *supra* note 1, ch. 3, article 301 (" [N]ational treatment shall mean, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded by such state or province to any like, directly competitive or substitutable goods, as the case may be, of the Party of which it forms a part."), *with* USMCA, *supra* note 2, Article 14.4 ("[National treatment] means, with respect to a government other than at the central level, treatment no less favorable than the most favorable

allow "national treatment" for a foreign investor will depend on "the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate welfare objectives."[20] This qualification introduces not a minor amount of lassitude in the interpretation of the prescription.

## III. FUTURE OF INVESTMENT ARBITRATION UNDER THE USMCA

It is not an easy task to explain and justify the introduction of a privileged scheme that substantially benefits the investors and their investments included in the five covered sectors in obvious detriment to investors operating in non-covered sectors of the economic system, especially where those non-covered investors were previously entitled to claim incentives and rights under NAFTA.

There does not seem to be a precedent in investment arbitration treaties to grant privileges to investors operating within certain covered sectors and simultaneously discriminate against all other investors. It is still too early to assess the manner in which investors, be they beneficiaries of the USMCA rules favoring covered sectors or those excluded from this privileged system, will react to this innovative scheme. Perhaps measuring the flow and volume of future foreign investment to Mexico, under the pathways of both the covered and the uncovered sectors, will allow a determination and evaluation of the virtues, the usefulness, and the impact to the economy as a whole of the two distinct systems the USMCA has established.



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treatment accorded, in like circumstances, by that government to investors, and to investments of investors, of the Party of which it forms a part.").

[20] USMCA, *supra* note 2, Article 14.4.

**INSTITUTE FOR TRANSNATIONAL ARBITRATION**
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The Institute for Transnational Arbitration (ITA) provides advanced, continuing education for lawyers, judges and other professionals concerned with transnational arbitration of commercial and investment disputes. Through its programs, scholarly publications and membership activities, ITA has become an important global forum on contemporary issues in the field of transnational arbitration. The Institute's record of educational achievements has been aided by the support of many of the world's leading companies, lawyers and arbitration professionals. Membership in the Institute for Transnational Arbitration is available to corporations, law firms, professional and educational organizations, government agencies and individuals.

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