



## Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues

No. 269 January 13, 2020

Editor-in-Chief: Karl P. Sauvant ([Karl.Sauvant@law.columbia.edu](mailto:Karl.Sauvant@law.columbia.edu))

Managing Editor: Alexa Busser ([alexa.busser@columbia.edu](mailto:alexa.busser@columbia.edu))

### **The US-Mexico-Canada Agreement: the new gold standard to enforce investment treaty protection?\***

by

Orlando F. Cabrera C. \*\*

On November 30, 2018, the US, Mexico and Canada signed an agreement that, if approved, will replace the North America Free Trade Agreement (NAFTA): the [United States-Mexico-Canada Agreement](#) (USMCA). USMCA was negotiated under circumstances different from NAFTA. The US stood by its “America first” policy, among other protectionist policies. This ran counter to NAFTA-era neoliberal policies and previous US presidents’ efforts, since World War II, to establish international trade rules, arguing that they would bring stability to the world economy.<sup>1</sup>

The US proposal was to let parties unilaterally decide whether or not to opt in to the investor-state dispute settlement (ISDS) mechanism, and the US made it clear that it would not opt in. Canada’s preference was a more progressive ISDS mechanism akin to that of the EU-Canada Comprehensive Economic and Trade Agreement (CETA). For Mexico, dispute-resolution mechanisms had an essential role; Mexico wanted to retain provisions that contribute to investment transactions. The end result was a limited bilateral ISDS mechanism between the US and Mexico, which Canada did not join. Still, under the USMCA, Canada will have access to the state-to-state dispute settlement, to resolve investment disputes arising out of Chapter 14.

Chapter 14’s uniqueness rests on the claims covered by the bilateral (Mexico-US) ISDS mechanism for two distinct categories of investments. First, general investors can claim breaches only to national treatment, most-favored-nation treatment (only at investment’s post-establishment phase) and direct expropriation. Second, the “Covered Government Contracts” provisions allow investors that have concluded governmental contracts and related activities in oil and gas, power generation, public telecommunications, public transportation, and certain public infrastructure to claim breaches to the above three standards (even during the investment’s establishment phase) plus the minimum standard of treatment (including fair and equitable treatment and full protection

and security), transfers, performance requirements, senior management, and indirect expropriation.

Under Covered Government Contracts, Mexico and the US allow claims to all the standard protections in the sectors in which treaty breaches are most frequent. In 2018, ICSID reported that the largest shares of claims involved investments in oil, gas and mining (24%); electric power and other energy (17%); construction (8%); and water, sanitation and flood protection (5%). Altogether, these sectors represented 54% of all cases registered under the ICSID Convention and Additional Facility Rules.<sup>2</sup> The Mexican experience is similar: 40% of the investment arbitration cases against Mexico dealt with investments under Covered Government Contracts.<sup>3</sup> Interestingly, Mexico and the US left out mining, even though, from 1999 to 2016, FDI by US investors in Mexican mining amounted to US\$6.8 billion.<sup>4</sup> Instead, they preferred to cover energy and telecommunications, where US investors channeled, respectively, US\$4.6 and US\$5.9 billion.

Conversely, the US and Mexico decided, through the general investment section, to allow narrower enforcement of protections to the largest FDI flows from the US to Mexico. Between 1999 and 2016, manufacturing accounted for 49% of US FDI inflows.

In the current investment arbitration crisis, USMCA presents a new gold standard to enforce investment protection. First, under general investment, USMCA reduces states' risk exposure by precluding investors' access to ISDS for claims of alleged breaches to indirect expropriation and fair and equitable treatment standards, and national treatment and most-favored-nation standards at the investment's pre-establishment phase. Governments concerned with regulatory chill and the exercise of police powers should adopt the USMCA model, as it reduces the risk of ISDS claims related to the regulation of health, national security,<sup>5</sup> morals, and the environment. Philip Morris, which questioned the "plain packaging" and "single presentation" policies adopted by [Australia](#) and [Uruguay](#), would have had no grounds to advance a claim under USMCA. Also, with the Covered Government Contracts, governments will continue protecting the most sensitive sectors in which ISDS cases frequently arise.

A government willing to adopt the USMCA model should identify the sectors that, based on the relevance of investment flows and frequency of investment-treaty breaches, require the broadest protection, ponder the risks associated with these sectors and opt to protect the latter by bearing these risks. For instance, Colombia's highest 2018 inward FDI shares were in oil, financial services and mining. It should consider protecting the oil and mining sectors under Covered Government Contracts, and subject other industries (such as financial services, agriculture, manufacturing, and construction) to the general investments.<sup>6</sup> Governments should not fear that this results in lower investment flows, as the link between investment agreements and FDI flows remains tenuous.<sup>7</sup>

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\*\* Orlando F. Cabrera C. ([orlando.cabrera@hoganlovells.com](mailto:orlando.cabrera@hoganlovells.com)) is a Fellow of the Chartered Institute of Arbitrators (CI Arb) and Associate at Hogan Lovells, Mexico. The author is grateful to Vernon MacKay, Mélida Hodgson and an anonymous reviewer for their helpful peer reviews.

<sup>1</sup> [John Micklethwait, et al, \*Trump Threatens to Pull U.S. Out of WTO If It Doesn’t ‘Shape Up’\*, BLOOMBERG \(2018\).](#)

<sup>2</sup> [ICSID, \*The ICSID Caseload-Statistics, Issue 2018-2\*, \(2018\).](#)

<sup>3</sup> [UNCTAD, \*Investment Dispute Settlement Navigator\* \(Jan. 6, 2019\).](#)

<sup>4</sup> [Secretaría de Economía, “Inversión directa de Estados Unidos hacia México,” February 2017, pp. 26 \*et seq.\*](#)

<sup>5</sup> USMCA Art. 32.2 secures policy flexibility regarding national security through a general exception that applies to the whole treaty.

<sup>6</sup> [Banco de la República de Colombia, \*Flujos de inversión directa–balanza de pagos, 2018\*](#)

<sup>7</sup> Although Brazil is not a party to any treaty with ISDS, it leads in attracting foreign investment in Latin America. By contrast, Mexico is a signatory to 31 investment agreements, and it lags far behind.

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For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Alexa Busser, [alexa.busser@columbia.edu](mailto:alexa.busser@columbia.edu).

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